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CIS

FISCAL DISPARITIES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

PART 2

THE COMMERCE CLAUSE AND THE SEVERANCE TAX

JULY 15 AND 16, 1981 (WASHINGTON, D.C.), AND AUGUST 31, 1981
(ST. PAUL, MINN.)

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FISCAL DISPARITIES

WEDNESDAY, JULY 15, 1981

U.S. SENATE,
SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 9:07 a.m., in room 3302, Dirksen Senate Office Building, Hon. Dave Durenberger (chairman of the subcommittee) presiding.

Present: Senators Durenberger and Sasser.

OPENING STATEMENT OF SENATOR DURENBERGER

Senator DURENBERGER. The hearing will come to order.

Today, we begin the second in a series of oversight hearings on the topic of fiscal disparities. The focus of these 2 days will be on the ability of some States to raise substantial revenues by taxing their energy resources and, in the process, draining revenues from other States.

I spent a good amount of time over the past 2 years describing the complex web of problems caused by the transfer of wealth from the energy-consuming States of this Nation to the energy-producing States.

I have described this problem in terms of fiscal disparities, because it emphasizes the considerable differences among States' abilities to finance public services from their own resources.

This matter now takes on increased importance in light of President Reagan's efforts to return more responsibility to the States—the philosophy of the New Federalism. As the transfer of income and tax base continues from energy-rich to energy-poor States, we must carefully consider the increased burden devolution carries with it.

Is it feasible to return responsibility to States so widely different in their economic base without a corresponding Federal policy designed to compensate for these disparities? Is it fair to expect the States and localities that suffer from a declining economy to provide the same level of public services as those States flush with energy-generated revenues? Is it desirable in a Federal system to accept the different levels of public services that will inevitably result from an unabated flow of energy dollars?

The President is formulating an abstract theory of federalism that has at its core the return of responsibilities to the States. I applaud his efforts. But no abstract theory of this type is complete without a concrete counterpart which will make available to the States the necessary resources to provide those services that will now fall to them.

For energy-rich States this will be no problem, since they can turn to energy taxes to support these services. For other States their only choice will be between an increase in taxes or a decrease in services. Is it prudent to force some States into this Hobson's choice? The States that increase taxes lose a competitive edge to the energy-rich States in the rivalry for new business and investment. If they elect to decrease services, they run the risk of further stressing an already deteriorating social and economic infrastructure.

I know the President is sensitive to this issue. He has repeatedly stated that it is his dream to turn back to local and State governments the tax sources which the Federal Government has preempted. My concern is that any simple approach to this turnback, such as a proportionate return of the Federal income tax, is destined to perpetuate the considerable fiscal disparities that already exist.

The disparities arising from the uneven distribution of energy resources are reflected in numerous ways. The most direct is the greatly increased economic growth that accompanies energy resource development. Another is the increased royalty revenues that go to State governments. And, yet another is the greatly increased revenues from severance taxes which flow into the States' treasuries. While this last source is our focus today, it obviously cannot be divorced from the others.

To give you a feel of the magnitude of the problem, consider the conclusions of a recent study by the Federal Reserve Bank of the Ninth District. From 1972 to 1978, the study estimates that the income transfer from energy-consuming States to producing States in the United States amounted to about one-half the income transfer which occurred from the United States as a nation to foreign oil producers. If the drain of U.S. capital to the Arab sheiks is of concern, and I believe it is, then certainly a domestic transfer of this magnitude in this short period of time deserves our close scrutiny.

In light of the President's thinking on federalism, this takes on a new urgency. If we are not careful, we stand the risk of dumping greatly increased responsibilities on States that have not had the opportunity, nor the means, to recover from the shock of this energy-induced transfer.

Projections made by the Treasury Department and the Bureau of Mines reveal the scope of the problem:

The Treasury projects that by 1983, energy-related severance taxes are likely to yield about $9.4 billion annually, up from $2 billion in fiscal year 1977 and $3.8 billion in fiscal year 1980.

The Bureau of Mines projects that total Federal and Indian royalty revenues will increase from $306 million in 1977 to about $4.3 billion in 1990.

The problem makes this a timely hearing. The Supreme Court's July 2 decision in the *Commonwealth Edison Co.* v. *Montana* case[1] makes this an urgent hearing. The Court held that coal mining is definitely an activity in interstate commerce and that, in the absence of congressional action restricting them, the States may tax that commercial activity at very high rates—at least 30 percent.

---

[1] See p. 614.

While the Court ruled the tax was constitutional, it did not say the level of taxation was appropriate. In fact, the Court indicated it was not competent to find any level appropriate. The Court held that Congress had the power, under the commerce clause, to restrict severance taxes if it found it in the national interest.

One important question we must consider at these hearings is precisely where is the national interest in this complex problem? While the decision dealt specifically with coal, the implications go to severance taxes on all other natural resources as well.

We have the foundation in this country of a national energy policy. With the decontrol of oil, Congress said that, to achieve efficiency in the domestic allocation of oil, we would permit the domestic market to allocate oil unfettered by price controls and complex allocation schemes.

The price of oil would run up to the cartel price. Vast economic rents would accrue to producers, but the domestic market mechanism would work to allocate oil efficiently. Congress then went on to adopt the windfall profits tax to withdraw those economic rents and redistribute them consistent with a nationally determined policy. It is not consistent with this policy to permit a handful of States to become rich themselves by hitching their revenue source to the cartel pricing of OPEC.

The other important issue, of course, is the prospect of economic warfare. Dollars that flow to energy-rich States as a result of decontrol of oil and natural gas, coupled with the revenues from State energy taxes and royalties, will permit a few States to reduce other taxes on income, capital, and property. As I have said before, new capital investment and job opportunities will follow the energy dollar.

As this process accelerates, the temptation will be overwhelming for States to become engaged in a dangerous competition with one another. I already hear rumblings in my own State of Minnesota that, in order to protect ourselves, Minnesotans should quickly develop our own vast nonenergy mineral resources and then tax them to the hilt.

Looking at this from the State's perspective, this conclusion is perfectly understandable. But from the national perspective, if every State begins thinking—and acting—in those terms, the effect on the Nation's economy would be disastrous.

This is precisely the situation the commerce clause was intended to prevent. Left to their own devices the individual States have no other recourse than to throw up walls of self-interest and self-defense. That is why it is up to the Congress to examine these issues closely and determine what can be done to prevent this form of economic warfare.

Fiscal disparities arise in numerous forms and yield to no single comprehensive solution. It is imperative that we become aware of their many manifestations and begin to think about the range of solutions available to us.

In the *Montana* case, the Court returned the issue of energy taxation to the Congress. Make no mistake, Congress will make policy in this area. We may do so by not acting, but our very inaction will set the course of national energy policy in regard to how we develop and tax our natural resources. It will determine the nature of intergovernmental relations for the foreseeable future.

I would like to begin by thanking all of the witnesses who have agreed to appear today and at the hearing tomorrow. There will be further hearings on this subject during the course of this Congress.

At this point in the hearing record I would like to insert a letter from Robert W. Rafuse, Jr., Deputy Assistant Secretary for State and Local Finance of the Department of the Treasury. This letter was in response to my request for data on the energy-related severance taxes in connection with the revenue sharing program. His letter includes a table on the energy-related severance taxes by State for fiscal years 1972, 1977, 1980, and 1983.

[The letter follows:]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

July 24, 1981

Dear Senator Durenberger:

In response to your telephone request of July 17, 1981, I am enclosing a table of energy-related severance-tax data from our forthcoming study of such taxes in connection with the Revenue Sharing Program.

The table shows actual data for fiscal years 1972, 1977, and 1980 and forecasts for 1983. The 1983 data would, under current law, enter into the calculation of the 1985 Revenue Sharing allocation, if the Program were renewed in 1983. The table is preliminary and is from our draft report on the outlook for State severance taxes and their effect on on the interstate allocation of Revenue Sharing.

The table shows two forecasts of the yields of energy-related severance taxes in FY 1983--the control forecast and the total forecast. The control, in column 4, is our forecast of the growth of such severance taxes from 1977 to 1983 in the absence of the energy crisis. The forecast is derived on the basis of an estimate of the relationship between rising severance-tax yields and growth in the GNP.

The total forecast presented in column 5 comprehends all conditions expected to prevail, including the effects of the energy crisis. This forecast is calculated by applying 1980 severance-tax rates to forecasts of the bases of each type of severance tax derived from energy price and production forecasts. These forecasts are described in pages 5 and 6 of my testimony before your subcommittee on May 13, 1981. Column 6 of the table shows the differences between the total and the control forecasts. These are the increases in severance-tax yields attributable to the energy crisis.

Please let me know if you have any questions. I appreciate the opportunity to provide you with the information. A copy of the report will be sent to you as soon as it is available.

Sincerely,

Robert W. Rafuse, Jr.
Deputy Assistant Secretary
(State and Local Finance)

Mr. Larry Hunter
Subcommittee on
Intergovernmental Relations
Committee on Governmental Affairs
Room 507, Carroll Arms Building
300 1st Street, N.E.
Washington, D.C. 20510

Enclosure

TABLE 5

YIELDS OF ENERGY-RELATED SEVERANCE TAXES BY STATE; FISCAL YEARS 1972, 1977, 1980 AND 1983 (millions)

	Actual Collections			FY 1983 Forecasts		
State	FY 1972 (1)	FY 1977 (2)	Preliminary FY 1980 (3)	Control Forecast (4)	Total Forecast (5)	Excess of the Total Over the Control[a] (6)
United States	$714.4	$2,015.8	$3,816.7	$3,290.3	$9,207.8	$5,917.6
Alabama	4.1	12.2	30.6	20.9	124.7	103.8
Alaska	14.9	23.8	506.5	40.8	2,116.9	2,076.1
Arizona	-	-	-	-	.3	.3
Arkansas	3.3	8.0	14.6	13.7	44.2	30.5
California	1.6	1.5	3.5	2.6	8.6	6.0
Colorado	.6	2.3	19.8	3.9	92.0	88.0
Connecticut	-	-	-	-	-	-
Delaware	-	-	-	-	-	-
Dist. of Col.	-	-	-	-	-	-
Florida	2.3	26.4	57.3	45.3	216.1	170.8
Georgia	-	-	-	-	-	-
Hawaii	-	-	-	-	-	-
Idaho	-	-	-	-	-	-
Illinois	-	-	-	-	-	-
Indiana	.2	.6	1.6	1.0	1.8	.8
Iowa	-	-	-	-	-	-
Kansas	.7	.8	1.1	.3	.3	-
Kentucky	5.9	113.0	177.3	193.8	252.3	58.5
Louisiana	236.5	485.3	513.2	670.3	1,022.0	351.7
Maine	-	-	-	-	-	-
Maryland	-	-	-	-	-	-
Massachusetts	-	-	-	-	-	-
Michigan	1.0	9.5	43.3	16.3	210.5	194.2
Minnesota	-	-	-	-	-	-
Mississippi	13.1	23.4	50.2	40.1	112.4	72.3
Missouri	-	-	-	-	-	-
Montana	3.2	41.4	87.8	71.0	182.9	111.9
Nebraska	.6	1.1	2.9	1.9	4.4	2.5
Nevada	-	*	*	*	*	*
New Hampshire	-	-	-	-	-	-
New Jersey	-	-	-	-	-	-
New Mexico	35.2	101.5	198.3	174.1	323.3	149.2
New York	-	-	-	-	-	-
North Carolina	-	-	-	-	-	-
North Dakota	3.3	15.4	43.9	26.4	106.2	79.8
Ohio	.7	2.9	3.4	3.3	3.3	-
Oklahoma	73.3	191.4	436.1	328.3	709.3	381.0
Oregon	-	-	-	-	-	-
Pennsylvania	-	-	-	-	-	-
Rhode Island	-	-	-	-	-	-
South Carolina	-	-	-	-	-	-
South Dakota	-	*	.4	*	3.3	3.3
Tennessee	-	2.1	2.2	2.9	3.8	.9
Texas	307.4	902.8	1,519.9	1,548.6	3,174.7	1,626.1
Utah	1.4	6.4	7.0	9.1	27.7	18.6
Vermont	-	-	-	-	-	-
Virginia	-	-	-	-	-	-
Washington	-	-	-	-	-	-
West Virginia	-	-	-	-	-	-
Wisconsin	-	-	-	-	-	-
Wyoming	5.1	44.0	95.8	75.5	466.8	391.3

*Less than $0.5 million.

[a] The amount by which the total exceeds the control is the increase attributable to the energy crisis.

Sources: U.S. Bureau of the Census, State Government Tax Collections, various years.

Senator DURENBERGER. Our first witness this morning really needs no introduction. William Rogers has served under several Presidents, including President Eisenhower as Attorney General, and President Nixon as Secretary of State. He is the senior partner of the Rogers & Wells law firm, and recently argued the *Montana* case before the Supreme Court.

Mr. Secretary, we welcome you to the hearing.

TESTIMONY OF WILLIAM P. ROGERS, ROGERS & WELLS LAW FIRM

Mr. ROGERS. Thank you, Mr. Chairman. I am pleased to be here this morning to talk to you informally about this subject. Certainly, there is nothing more important in our country than the relations between the Federal Government and the State governments. That has been true throughout our history.

In drafting the Constitution, the Founding Fathers anticipated the problem and, as a consequence, included the commerce clause. This clause deals with the question of interstate commerce, what the Federal Government can do and what the States can do.

It is interesting that we have managed to do very well throughout history. The States have had to make some adjustments, and the Federal Government has made adjustments. The Supreme Court has played a very vital role in that process, and Congress has played a very vital role in that process.

I think it is important to deal with this subject in specific terms. When you talk about it in generalities, it doesn't have much meaning. However, when you discuss it in specifics, it takes on meaning and is much more understandable.

I am happy to be here because I did just argue the case to which you referred—the *Commonwealth Edison Co.* v. *Montana* case. It was decided by a 6-to-3 decision in the Supreme Court that the case should be dismissed.

I think it would be well to take just a minute to talk about the facts, because that is what is essential in this case.

It is interesting to me, looking at the history of the law in this field, that there have been so few cases dealing with the limits on the States' power to tax. Most cases have involved the question of the Federal Government's power to regulate activities or, more importantly, the power of the States to tax at all. Most cases have involved activities which were claimed as not being subject to State taxes, because they were in interstate commerce and, thus, immune from State taxes.

In most cases the Court has held that even though a person's activity in the State is quite minor, that person still is required to pay State taxes. Then the Court laid down a general formula that should be applied to determine the maximum amount the State should be permitted to tax, assuming that an activity was in interstate commerce.

Prior to the *Montana* case, the law appeared to be that the mining of coal was an intrastate activity and, therefore, subject to tax and not subject to any control, either by the Federal Government or by the courts. That is because in the *Heisler* case the mining of coal was determined to be an intrastate activity. It was not subject to control by the Congress nor subject to scrutiny by the Court.

In 1975, Montana enacted a severance tax in the approximate amount of 30 percent of the value of the coal severed. Prior to that time, Montana had a whole range of taxes that applied to coal mining. It had a property tax, an income tax, a small severance tax and other taxes. But in 1975—and I am speaking now from the record of the legislative history of the State—Montana decided that it would increase the severance tax to 30 percent of the value of the coal. This was over and above all the other taxes that the State then imposed on the mining of coal.

There is no doubt of what the Montanans intended to do. They intended to take advantage of the energy crisis in this country, and they said so. And that was done. In addition, Montana said, "Because we can't possibly use all the money we are going to get from this tax, we are going to create a trust fund which we will establish under the State constitution. We will pass a constitutional amendment, set up a trust fund in perpetuity, and put 50 percent of the proceeds from that tax into this trust fund." They can do that.

I think it is well to keep in mind that there is not an open market in the coal mining business. The utilities have to decide where they are going to put the generating plant. The coal companies have to make a lease with the Federal Government, in most cases, because the Federal Government owns about 75 percent of the coal. The utilities make a long-term lease to buy that coal from the coal company, and the leases run 20, 25 or 30 years.

The coal companies have no choice in the matter, once they have made the lease. The utility companies have no choice in the matter either because they are bound, by contract, to buy the coal for 20 to 30 years. Furthermore, the contract provides that any increases in the taxes are passed on to the buyer and the buyer, by law, is permitted to pass that onto the consumer. So there is not an open market.

Market forces don't come into play at that time, and this was understood. The legislature in Montana said that. In fact, the author of the bill pointed out that these taxes are going to be paid by the consumers in Chicago, Detroit, Minneapolis, and other places. There was no way for anybody to get out of it. So the 30-percent tax is added to the electric bills in these other States without any regard in the State of Montana to the impact. Now, although there is some discussion in Montana about reclamation, it is really irrelevant in this case because the Federal Government and the States require reclamation. The companies have to put up a bond to reclaim, and they reclaim as they go along. So Montana did not even claim that this money was necessary for purposes of reclamation.

Furthermore, most of this coal is owned by the Federal Government. Montanans speak about the coal being their coal, but actually 75 percent of it is owned by the Federal Government. In addition, 90 percent of it is shipped out of the State.

The State is taxing far beyond its needs, as is clearly demonstrated by the fact that Montana is putting the money into a trust fund for future generations. Montana admitted that it had sufficient revenues in 1975 from other taxes and that the purpose of the 30-percent severance tax merely is to pass on the burden to the consumers in other States.

Montana has 25 percent of all the coal reserves in the United States.

It also has 40 percent of the low sulfur content coal. Most of the coal is shipped out of the State. The Federal Government owns 75 percent of it, notwithstanding the fact that Montana taxes the coal, as I have said. In addition, the attorney general of the State said that they were entitled to tax not only at a rate of 30 percent but at 100 percent or even 1,000 percent. Justice Blackmun pointed out that this was terrible. He said it is remarkable that Montana makes this claim. At the present time, Montana gets 20 percent of all of its revenues from this tax.

I think when outsiders read about the coal mining in Montana, they have a feeling it is a huge massive area that is covered. In fact, I think the total acreage is about 5 square miles that is being mined now.

The estimates are that, in the next 10 years, Montana is going to collect severance taxes that amount to roughly $2 billion. Justice Blackmun pointed out that there are estimates that by the year 2010 Montana will collect $20 billion.

We challenged the tax on the ground that it was outrageously high. We said that because of the law, as we read it from other Supreme Court cases—although there had never been a direct holding on this issue since 1922. In 1922 the Court held the activity was intrastate commerce and, therefore, was not subject to scrutiny by the courts or control by the Congress.

The Supreme Court now has held that mining coal is interstate commerce and subject to the scrutiny of the Court under the Constitution. However, it said,

> We, the Court, do not believe we should get involved in this. It is too complex and, therefore, we think this is a matter for Congress to handle.

So the case is very significant, because it destroys the argument that Montana was making—that the Congress has no right to get involved in this. It has cleared the air. There is no doubt that Congress can act in this area. I submit that, for the future good of the country, the Congress should enact some kind of a brake on these taxes.

It is interesting that Justice White wrote a concurring opinion. He concurred with the majority but he really agonized over it. He started out by saying,

> This is a very troublesome case for me, and I join the Court's opinion with considerable doubt and with the realization that Montana's levy on consumers in other States may, in the long run, prove to be an intolerable and unacceptable burden on commerce. Indeed, there is particular force in the argument that the tax is, here and now, unconstitutional.

Then he proceeds to say,

> The Constitutional authority and the machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress. Surely, Montana and other similarly situated States do not have the political power to impose their will on the rest of the country.

So as I say, Mr. Chairman, I do think this is an extremely important issue. The Supreme Court recognized, I think, that this tax was outrageous.

We, in our presentation to the Court—this is the point I want to underline today, and I think it is the one you initially made, Mr. Chairman—urged that if we accept the thesis espoused by Montana, it could lead, as a practical matter, to the Balkanization of this country. It could cause a situation in which the energy-rich States would be permitted to extract tribute from those which are energy-poor, a tribute which bears no relation to the needs of the taxing State. This is the same overriding theme that has been pursued throughout the history of this country.

I fear that the Supreme Court's decision, unless corrected by Congress, will carry us further along this road to a national division between the energy-rich States and the States which are energy-poor.

As I pointed out in court, Montana has argued that unless Congress intervened, it was free to raise its severance tax to 100 percent or even 1,000 percent. Justice Blackmun pointed out that the Court really accepted that point of view.

The Court's decision is not yet quite 2 weeks old, but I have already heard that proposals to increase taxes on energy resources are being made. For instance, the attorney general of Texas has already proposed that the Texas legislature consider a retaliatory increase in its oil and gas severance tax. That is just a first reaction. There are bound to be many more reactions of other States.

If there is no limit to the tax a State may impose on interstate commerce, particularly in the field of minerals and energy, then it is bound to lead to retaliation by other States.

Obviously, these taxes are politically popular in States where they are being imposed because they fall largely on consumers in other States. Thus, in considering this problem, we must reflect on what the Founding Fathers really did in 1789 when they transformed the Articles of Confederation into our Constitution and transformed a Federation of States into a Nation. They subordinated the economic rights and benefits of the individual States to the economic rights and benefits of the Nation as a whole. They anticipated that this might not always hold true when the commerce clause was enacted.

It is now clear, as a result of the Supreme Court's decision, that the Congress will have to be the final arbiter of such issues between the States.

We have heard it said that taxation, and particularly mineral taxation, is a matter of States' rights. Within this framework, the question presented is "Which States' rights?" Those of Montana and Wyoming, or the rights of Michigan, Illinois, Minnesota, Iowa, Texas, Arkansas and the other consuming States? The coal is owned by all of us, all the people in the country, not just Montana and Wyoming.

By the mid-1980's, there will be at least 21 consuming States. Ninety-five million citizens of those States will be paying tribute to the 1.3 million citizens in Montana and Wyoming because a large part of the Nation's coal happens to be located in those States. Under these circumstances, it seems clear that the rights of the consuming States are paramount and that, within this parameter of States' rights, the Congress should act.

I emphasize again that we are not talking about restricting the power of Montana and other States to generate revenues to meet legitimate needs. We recognize that interstate commerce has an obligation to bear its fair share of the tax burden of a State. We are talking about challenging the notion that any single State—or any handful of States—can hold the rest of the country to ransom simply because of the fortuitous location of energy resources, much of which is federally owned.

The severance, transportation, and use of energy resources all have a substantial impact on interstate commerce. The Supreme Court so held. They are national questions, vital to the national interest. That is precisely the sort of question which was the core of the change in 1789 from the Articles of Confederation to our present Constitution.

Congress has the obligation to mediate disputes between States over resources; yet, the Congress is now effectively at a crossroads. It can either ignore the situation—which, as you said, Mr. Chairman, is a policy decision—and watch this problem grow day by day until it begins to tear this country apart, or the Congress can act now—wisely, but with determination—to stop the Balkanization of a Nation which has already begun.

Thank you very much.

Senator DURENBERGER. Thank you very much, Mr. Secretary. I think it is fair to say, as I have talked to people on both sides of this issue, that one of the things which is shared is an uneasiness about how to resolve the many questions involved.

No one believes the issue has been resolved by the decision in the *Montana* case. Part of the problem is that it isn't—just as you say—an accident of the location of minerals. It is the impact of bad national energy policy in this country over the last few years that has helped to create this situation. Certainly it played a role in both the price and the demand for a variety of energy resources.

As we approach a congressional responsibility for either acting or not acting, all of us would appreciate whatever guidance someone, who has dealt with this system as long as you have, might give us on how to deal with the issue of reasonableness in some broad definition.

On its face the approach which was mine in another forum—a 12½-percent limitation on coal severance taxes—may not be the best answer if you look at the impact of the severance tax in Montana, compared to the impact of the severance tax on oil in Texas, or the severance tax on oil in Senator Stevens' State of Alaska.

Montana's 30-percent severance tax doesn't generate one-tenth the money that the 5-percent Texas oil tax does, or one-thirtieth the money generated in a State like Alaska by a 15-percent tax. And yet a lot of the other regulations, grants, and taxes that offset the cost of extraction are distributed equally to all the States.

Should we approach this issue in terms of percentages or in terms of costs, looking at the dollars involved? Are there any easy solutions which may be available to us here in the Congress?

Mr. ROGERS. I think that is a fundamental question. I don't have a ready answer, but I do have a general answer.

The system only works if the States are willing to work within the constitutional framework. Everyone who talks on this question says it is so difficult to know what is right. One of the arguments made in the State courts was, "Well, the courts are going to be asked to fix the tax to determine what is correct." I don't think that follows. This is the first case of its kind that has been brought before the Court since 1922. The relationship in interstate commerce between the Federal Government and the States has worked pretty well.

What is dangerous about this situation? It is dangerous because Montana clearly said, "Let's just grab all we can." There was no effort made to justify the tax, and there was no effort to relate it to anything. The State legislature said, "Look at what they are doing in Canada. Look at how much they are getting there. Let's try to get more."

Some legislator said: "I talked to a leading citizen—I won't name him—who said, 'There is no way they could really justify more than 15 percent under any formula.' They just said, 'Let's double it.' Now they are saying they can go to 1,000 percent.' So I think if people in the States realize that there is some limit and somebody is going to check on it, then the matter may fall into place.

The coal companies and utility companies were not complaining about the 12½ percent. Even that level would really be excessive in Montana. They don't possibly need that much. Even assuming the Congress sets it at 12½ percent, at least they would know there was some limitation.

I think the danger in this country is that, as Justice Blackmun said, "Implicit in the Supreme Court's decision is the notion that there is no limit, and that you—the States—can do anything you want to do. The courts are not going to trouble you. We are not going to bother you. It is too complex for us."

If the Congress also says, "It is too complex for us," then we are going to start a war. We are going to have a Balkanization of this country. It is an invitation for every politician in the country—it doesn't have to be minerals; it could be lumber or anything else—to sock it to the other States.

The 12½ percent idea is a good idea. I think, if the Congress enacted it, it would give the States plenty of opportunities to have more than enough revenue. The revenue Montana is going to get from the mining of this coal is tremendous. By the turn of the century, even with a 12½-percent levy, they won't need any State taxes. This is all the tax they need. We could all move to Montana.

It is a matter of degree. The States have to recognize there is a problem, and they have to work within the system. If Congress sets a limit—we don't know exactly what it shall be—and if the States conduct themselves with a certain constraint, they could demand companies doing business in the States to pay their fair share and then some.

There would be no argument here if the State of Montana wanted to use money to build schools and roads, or anything else they can think of. We pointed out to the Supreme Court that our study shows that if they paid for everything they say they want to which relates to the impact of mining coal, it would only require 4 cents a ton.

Senator **Durenberger**. Mr. Secretary, let me ask you about fairness. There is another test which some of us thought could be used—other than the percentage test. That is the reasonably related test. Just to deal with your suggestion of the 12½ percent, it is fair to say, in two States—I will just stick with coal—we have Montana and North Dakota. In Montana clearly 90 percent plus of the coal is being exported. Everybody knows it. There is no need for a Supreme Court decision to tell us whether or not they are taxing interstate commerce. In North Dakota, on the other hand—principally because of the type of coal, lignite—the decision the utilities made was to build their generating facilities in North Dakota and export the power. It would be very difficult for North Dakota to get the same sort of benefit from a 12½-percent severance tax as would Montana. North Dakotans, in a large part, may be paying some of that tax, for example.

It leads me back to the test I thought we had—the reasonably related test. The majority of the Supreme Court implied that you, representing the appellants, had completely misunderstood the meaning of the reasonably related test. Did you actually misunderstand it, or has the Court actually changed the meaning in some way?

Mr. ROGERS. I am glad you asked that question. It is really a joke to say we misunderstood it, because every decision of the Supreme Court, in recent years, dealing with this subject has been written by Justice Blackmun. So we read what the Court held and what the Court said by reading what Justice Blackmun wrote. Justice Blackmun, in his dissent, agrees with us completely. So for the Court to say we didn't understand what they said is ludicrous, because he agrees. We understood exactly what they said. What the Court really said, if you read it, is simply, "This is too difficult for us to deal with, too complex; let's leave it to Congress." You can see that they agonized over the complexity of it. Justice Blackmun said "It is not as complex as the majority says it is; we should not wash our hands of it just because it is a difficult issue." I think the better procedure would have been to do it the other way, so that the plaintiffs would have to go through State courts—you can't go to Federal courts in the first instance. This would require some States——

Senator DURENBERGER. It is my impression that the Court did not just leave the issue of what is reasonably related to the legislative process. It changed the meaning of reasonably related. In effect it did away with the fourth prong of the *Complete Auto Transit* test.

Mr. ROGERS. I think it did by the device Justice Blackmun points out. It is a difficult logic to follow. The majority says that if the tax has the right "measure"—whatever that means—then the Court won't look at it. But Justice Blackmun points out that that doesn't mean anything. He said, "It is not what you call the tax; it is the effect of the tax—how big it is, and what its effect is on business." Therefore, Justice Blackmun says that "fairly related" means exactly what you would think it means. It means "fairly related to what is happening in the State." Eliminating "fairly related" and saying something like "measure," Mr. Chairman, was really a device to shuck off the case. They couldn't follow their precedents logically, based on what they had previously said. They didn't want to deal with it. So, Justice Marshall just accepted this device which was dreamed up by the Solicitor General as a basis for that.

I think the majority's rationale is totally exploded by Justice Blackmun's analysis. However, having said all these things, the result is that the Court has left it to Congress. Therefore, I think Congress has an obligation to act.

I do not think Congress should attempt to determine what is "fairly related." In effect, I think the Congress should say, "We are going to put some limit on it, and you will have to work within that limit." The limit could be a good deal higher than the need for taxes; 12½ percent is a lot more than the States need. That is why I think the proponents of the pending Senate bill made it higher than the States need. I think, in the case of Montana, probably a 5-percent severance tax would provide all the revenue they could possibly need or justify.

I plead with the Congress to take some action, otherwise the States will do exactly what Montana has done. They will impose the tax, collect the revenue, and spend it. Then it is a catchup problem. How does Congress catch up with them? Once they have the money, they will spend it. I think one of the reasons the Court was reluctant to do anything is because Montana had spent a lot of this money. As I said earlier, they will have $1 billion in the next 8 or 10 years.

Senator **Durenberger**. Thank you very much, Mr. Rogers. I am going to yield, at this point, to the ranking member of the subcommittee. Jim, I think you have an opening statement.

OPENING STATEMENT OF SENATOR SASSER

Senator **Sasser**. Thank you, Mr. Chairman. First, I wish to commend Senator Durenberger, the chairman of our subcommittee, for holding these hearings on the intergovernmental impact of State severance taxes. Today's investigation of the fairness of State severance taxes once again demonstrates our Minnesota colleague's concern for fiscal equity in our Federal system.

Our Nation is a "Union of States." Each State, in some measures, has its well-being affected by other States. Minnesota derives much of its energy from Montana and North Dakota. My native State of Tennessee derives its natural gas, on which we are very dependent, from Texas, Louisiana, and Oklahoma. At the same time, Tennessee's farm products are shipped for export through New Orleans, and Minnesota's iron ore goes to the steel mills of Pittsburgh. So each State depends on a sound system of interstate commerce. All States have a stake in seeing to it that no one State, or handful of States, takes undue advantage of its economic advantages in a national system of commerce.

Our political system recognizes the sovereignty of States under a Federal system. It is elementary to every student of the Constitution that all powers not delegated to the Federal Government are reserved for the States under the 10th amendment. Certainly, our system recognizes the right of a State to tax resources within its border. So, I think our hearing today, Mr. Chairman, is very significant. We are investigating the burden that State severance taxes are placing on our system of interstate commerce.

We are also assessing whether there should be limits placed on States' ability to tax economic resources within its borders.

Ninety percent of Montana's severance taxes are paid by coal consumers in other States. Between 1976 and 1979, out-of-State consumers paid $123 million to support the cost of the Montana State government. We also know that 50 percent of Montana's coal severance revenues are placed in a permanent trust fund which is virtually unrelated to the cost of coal extraction. Less than 9 percent of severance tax revenues are earmarked for local impact aid in that State.

In 1978, Wyoming and Montana received some $100 million in coal severance taxes. Ninety million dollars of these revenues were paid by the residents of 21 States. By 1987, consumers in 27 States will pay over $360 million to Wyoming and Montana as the demand for low-sulfur coal continues to rise. As a result of these taxes, Montana is projected to have an $85 million budget surplus in 1990, while Wyoming will have a whopping $328 million surplus in the same period.

Obviously, we are getting into an era of distortion as far as severance taxes are concerned.

Mr. Chairman, I would like to have the rest of my statement included in the record.

Senator DURENBERGER. It will be made a part of the record.

[The statement follows:]

PREPARED STATEMENT OF SENATOR SASSER

I wish to commend Senator Durenberger, the chairman of our Subcommittee on Intergovernmental Relations, for holding these hearings on the intergovernmental impact of State severance taxes. Today's investigation of the fairness of State severance taxes once again demonstrates my colleague from Minnesota's concern for fiscal equity in our Federal system.

Our Nation is a union of States. Each State, in some measure, has its well being affected by other States. Minnesota derives much of its energy from Montana and North Dakota. Tennessee derives its natural gas from Texas, Louisiana, and Oklahoma. At the same time, Tennessee's farm products are shipped for export via New Orleans, and Minnesota's iron ore goes to the steel mills of Pittsburgh.

So every State depends on a sound system of interstate commerce. All States have a stake in seeing to it that no one State or a handful of States takes undue advantage of its economic advantages in a national system of commerce.

Yet our political system recognizes the sovereignty of States under a Federal system. All powers not delegated to the Federal Government are reserved to the States under the tenth amendment. And certainly our political system recognizes the right of a State to tax resources within its borders.

Thus, our hearing today is most significant; we are investigating the burden that State severance taxes are placing on our system of interstate commerce. And we are also assessing whether there should be some limits placed on a State's ability to tax economic resources within its borders.

This is not an investigation which should be entered into lightly. But it is an inquiry that we must not shy away from. The recent Supreme Court decision, *Commonwealth Edison Co.* v. *Montana*, lays this controversy directly before the Congress. As Justice White stated in his concurring opinion:

"Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. . . . The constitutional authority and machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to the Congress, and surely Montana and other similarly situated States do not have the political power to impose their will on the rest of the country. As I presently see it, therefore, the better part of both wisdom and valor is to respect the judgment of the other branches of the Government."

The record that will be laid before us will be a sobering one.

Ninety percent of Montana's severance taxes are paid by coal consumers in other States. Between 1976 and 1979, out-of-State consumers paid $123 million to support the cost of Montana State government. We will also note that fifty percent of Montana's coal severance revenues are placed in a permanent trust fund virtually unrelated to the costs of coal extraction and that less than 9 percent of severance tax revenues are earmarked for local impact aid.

In 1978, Wyoming and Montana received some $100 million in coal severance taxes. $90 million of these revenues were paid by residents of 21 States. By 1987, consumers in 27 States will pay over $360 million to Wyoming and Montana as the demand for low-sulfur coal continues to rise. As a result of these taxes, Montana is projected to have an $85 million budget surplus in 1990 while Wyoming will have a whopping $328 million surplus in that same year.

Not all States have excessive severance taxes. My own State of Tennessee has its own coal mines and its own severance taxes. We try to relate our severance tax directly to the problems we encounter in extracting coal in Tennessee. We charge 20 cents on every ton of coal extracted. This tax rate is less than 1 percent of the value of such extracted coal—far below the 30 percent of value severance tax rate imposed by the State of Montana. Indeed, 9 of the 14 States levying severence taxes on coal do so at a rate of below 4½ percent of the value of such coal.

These general statistics do not show the whole picture, however. The Federal Government supports Montana and Wyoming in dealing with coal impact costs. Producing States receive 50 percent of all Federal leasing royalties and an additional 40 percent of these royalties through the Federal reclamation fund. These royalty receipts can be used by the State legislature for a comprehensive list of impact-related costs, including planning, construction and maintenance and "public services."

In addition to these royalty monies, States receive impact aid under section 601 of the Powerplant and Industrial Fuel Use Act of 1978. This impact aid grant was intended to offset the increased use of coal intended by other portions of the act.

All in all, then, a small handful of States are receiving considerable revenues from consumers and taxpayers outside of their borders. And we are duty bound to undertake a frank assessment of the fiscal strains these taxes are placing on coal consumers throughout the country.

Certainly Montana, Wyoming, and other energy producing States have a right to tax their energy resources in order to help defray the cost of State and local government. And I am sure that Senator Melcher and Senator Wallop will provide ample testimony to that fact.

But let us use today's hearing as the beginning of a forthright and far-reaching inquiry into a very pressing political issue—the impact of State severance taxes on our interstate commerce in energy. And let us try to keep economic and political imbalances to a minimum.

Thank you.

Senator SASSER. Mr. Secretary, two quick questions.

You noted that the Supreme Court decision, in the *Montana* case, implied that Montana could raise its severance tax to 100 percent or 1,000 percent unless the Congress intervened. Now my question is this: Do you think Congress should intervene now to limit the Montana tax? Or, would we be better advised to assess the situation for a while and see whether or not the producer States will exercise some restraint and hold down the severance taxes or lower them in order to benefit the consumers generally? Have you given up on the idea that the rule of reason might prevail there, so we should act immediately?

Mr. ROGERS. I hate to comment adversely about Montana, as this may sound. However, I don't see any initiative at all on their part to reduce that tax. In fact, we talked to them before we really went ahead with this litigation in the hopes they would be reasonable.

It has gotten to be a tremendous issue. The tax is very popular because nobody in Montana is paying it. So everybody is strongly for the tax. As a matter of fact, when I was arguing the case in the Montana Supreme Court, it was a main issue in the election. The Governor was in the court. Each time there was a recess he went out on television, which was right outside the courtroom, and proclaimed what a wonderful thing the tax was. I didn't find any dissent. There were millions and millions of dollars taken from other States that weren't involved in the political process at all. As much as I like to hope the best side of human nature will emerge, I don't have much hope here.

Senator SASSER. We have seen severance taxes triple between 1978 and 1980. Now if severance taxes continue to escalate at that rate, can't Governors and attorney generals in other consuming States bring suits alleging, or asserting that an intolerable burden is being placed on interstate commerce?

Mr. **Rogers**. I don't believe they would be successful, in light of the Supreme Court's decision.

Let me say, too, Senator, when they talk about increasing a severance tax, they don't need to increase the rate very much. All they need to do is increase the amount of coal in Montana and the revenue is going to grow considerably.

If we have a national energy policy—which at least we claim we have—and if we say we want to encourage the use of coal—as we say in legislation—then the severance tax in Montana runs directly contrary to the energy policy. The attorney general of Texas appeared in the *Montana* case, and said that in some quarters of Texas some people are thinking about trying to get coal from South Africa and other places.

In other words, as the use of coal increases—and that is what we all hope—Montana is going to continue to get more and more money. There hasn't been as much development in Montana as there should have been; because Wyoming's tax is 17 percent and Montana's is 30, so new leases have been in Wyoming. Ultimately, however, they also will have to go to Montana. So the amount of money Montana is going to get out of the 30-percent tax is going to be terrific.

Senator **Sasser**. Thank you, Mr. Secretary. We have about a 1-percent severance tax in Tennessee. We have a lot of East Tennessee coal up there which we would be glad to sell to anybody if Montana's tax gets too high. It is a little high on sulfur content, but other than that——

Mr. **Rogers**. I don't think anybody could blame you for raising it a little bit.

Senator **Sasser**. Thank you.

Senator **Durenberger**. Thank you very much, Mr. Secretary. We appreciate you being here.

[The prepared statement of Mr. Rogers follows:]

PREPARED STATEMENT OF WILLIAM P. ROGERS

Mr. Chairman, I am pleased to appear before this Subcommittee.

The issue you are now exploring—whether Congress should put a brake on excessive state taxation of energy resources—is an important issue for the entire country.

These hearings come at a propitious time. As you know, less than two weeks ago the Supreme Court decided a case called *Commonwealth Edison Co.* v. *State of Montana* in which I appeared as counsel for the appellants. That case raised a constitutional challenge to a 1975 Montana law which imposed a 30 percent severance tax on the value of coal mined in Montana. This 30 percent tax was imposed after the Arab oil embargo began and was imposed on top of all the other taxes then on the books. It is currently the highest such tax in the nation, and serves as a model of excessive state taxes. In that legal action we alleged, among other things, that the tax was simply an attempt by Montana to maximize its revenues from a vital, national energy resource and that the amount of the tax bore no relation to any legitimate needs of the State. In fact, 50 percent of the tax goes into a trust fund for the use of future generations.

As you know, our claim was finally dismissed by the Supreme Court on July 2 as a matter of law. The plaintiffs were denied a trial so that there was never an opportunity to prove our claim in court. The majority of the Court held that the Commerce Clause of the United States Constitution, by itself, does not restrain states such as Montana from enacting any amount of severance taxes without regard to the factual impact such taxes may have on the rest of the country and without regard to the needs—or lack of needs—existing in the taxing state.

In reaching the conclusion that our clients' grievances could not be remedied in court, the Supreme Court squarely left the matter up to Congress. The majority opinion says (Slip Op. at 16):

"The appropriate level or rate of state taxation is essentially a matter for legislative, and not judicial resolution."

At another place, the majority opinion said (Slip Op. at 17):

". . . questions about the appropriate level of state taxes must be resolved through the political process. Under our federal system, the determination is to be made by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests."

Justice White, who concurred in this result, was even more emphatic. He said (Concurring Slip Op. at 1):

". . . Montana's levy on consumers in other states may in the long run prove to be an intolerable and unacceptable burden on commerce. Indeed, there is particular force in the argument that the tax is here and now unconstitutional."

His opinion also says (*id.* at 1-2):

"Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. It is also very much aware of the Nation's energy needs, of the Montana tax and of the trend in the energy-rich States to aggrandize their position and perhaps lessen the tax burdens on their own citizens by imposing unusually high taxes on mineral extraction. The constitutional authority and the machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress, and surely Montana and other similarly situated states do not have the political power to impose their will on the rest of the country."

The three dissenting judges forcefully argued that the courts had an active role to play in determining whether a state tax is so excessive that it imposes an undue burden on interstate commerce. They would have ordered a trial to hear the full extent of our proof. But that did not detract from their view that "the Constitution vests in Congress the power to regulate commerce among the states" and that Congress has ample power to act, if it chooses to do so. (*See*, Dissenting Slip Op. at 15-16.)

It is clear, therefore, that all nine members of the Court agreed that Congress has the power to act. Arguments, to the effect that Congress is without such power—some of which have been heard in prior legislative hearings—have been squarely rejected and expressly disapproved.

The question, therefore, is not whether Congress has the power to act but whether it ought to.

In our presentation to the Court, we urged that acceptance of the thesis espoused by Montana could lead, as a practical matter, to the Balkanization of this country through a situation in which the energy-rich States would be permitted to extract tribute from those which are energy-poor, a tribute which bears no relation to the needs of the taxing State. This is the same overriding theme we wish to pursue here. I believe it is fair to say that the three dissenting justices and Justice White all found this argument a powerful one. The majority did not reject this point; it merely said that we should address it to Congress.

I fear that the Supreme Court's decision—unless corrected by Congress—will carry us further along this road to national division between States which are energy-rich and those which are energy-poor. In court, Montana argued that, unless Congress intervened, it was free to raise its tax to 100 percent or even 1000 percent. The Court tacitly accepted that view, unless the power is limited by Congress.

Moreover, the Court's decision is not yet two weeks old but I have already heard that proposals to increase taxes on energy resources are being made. For instance, the Attorney General of Texas—who, by the way, fully supported our effort in the court—has already proposed that the Texas legislature consider a retaliatory increase in its oil and gas severance tax. That is just the first reaction; other States are sure to follow.

Thus, while Montana was certainly a leader in imposing excessive severance taxes, I fear that it will soon have many followers. This poses a grave problem for the Nation.

These taxes are obviously politically popular in the States where they are being imposed, as they fall largely on consumers in other States. Thus, in considering this problem we must reflect on what the founding fathers really did in 1789 when they transformed the Articles of Confederation into our Constitution and transformed a federation of States into a Nation. They subordinated the economic rights and benefits of the individual States to the economic rights and benefits of the Nation as a whole. They anticipated that this might not always hold true when the Commerce Clause was enacted. It is now clear that Congress will be the final arbiter of such issues between States. Since the courts will not act, Congress must.

We have heard it said that taxation, and particularly mineral taxation, is a matter of "States rights." Within this framework, the question presented is which States' rights? Those of Montana and Wyoming or the rights of Michigan, Illinois, Minnesota, Iowa, Texas, Wisconsin, Arkansas, and the other consuming States? By the mid-1980 there will be at least 21 States consuming coal from Montana and Wyoming—95 million citizens of those States will be paying tribute to 1.3 million citizens of Montana and Wyoming under the guise of a tax—because a large part of the Nation's coal happens to be located in those States. Under these circumstances it seems clear that the rights of the consuming States are paramount—and within this parameter of States' rights, Congress should act.

We are not talking about restricting the power of Montana and other States to generate revenues to meet legitimate needs. We recognize that interstate commerce has an obligation to bear its fair share of the tax burden. We are talking about challenging the notion that any single State—or any handful of States—can hold the rest of the country to ransom simply because of the fortuitous location of energy resources, much of which is federally owned.

The severance, transportation and use of energy resources all have a substantial impact on interstate commerce. The Supreme Court so held. They are all national questions, vital to the national interest. That is precisely the sort of question which was the core of the change in 1789 from the Articles of Confederation to our present Constitution. Congress has the obligation to mediate disputes between the States over resources, yet the Congress is effectively at a crossroads. You can either ignore the situation and watch this problem grow day by day until it begins to tear this country apart; or Congress can act now—wisely but with determination—to stop the Balkanization which has begun.

Senator DURENBERGER. Our next witness will be Walter Hellerstein.

Mr. Hellerstein is an associate professor from the University of Georgia, School of Law, and has dealt extensively in State taxation. His work was quoted in the majority and dissenting opinions in the *Montana* case.

I wish to inform everyone that our timing lights are not working, for some reason or another. This may be a relief to you. We have been trying to follow—when the timing lights work or don't work—as a general rule, 10 minutes for testimony and 10 minutes for questions, so we can stay on schedule. I read your written statement and it will be made a part of the record in full. You can abbreviate, if you wish. You have 10 minutes to summarize your statement. Thank you for being here.

TESTIMONY OF WALTER HELLERSTEIN, UNIVERSITY OF GEORGIA LAW SCHOOL

Mr. HELLERSTEIN. I am pleased and honored by the subcommittee's invitation to testify on the commerce clause and State severance taxes.

At the outset, I wish to disclose I have consulted with the State of Montana in connection with the *Commonwealth Edison Co.* v. *Montana* case, in which the Supreme Court sustained Montana's coal severance tax over commerce clause and supremacy clause objections. The views expressed here, of course, are entirely my own and do not necessarily represent those of Montana. Indeed, I can assure you they almost certainly do not represent the views of Montana.

My remarks are directed primarily to two questions bearing on the relationship of the commerce clause to State severance taxes. First, where do the Court's recent decisions, particularly its decision in *Commonwealth Edison Co.* v. *Montana*, leave the State of the law regarding the restraints that the commerce clause, by its own force, imposes on State severance taxes? Second, assuming that the Congress has determined to exercise its power under the commerce clause to limit State severance taxation, would such an exercise of congressional power be constitutional?

The Court's opinion in *Commonwealth Edison Co.* v. *Montana* makes it clear that a typical State severance tax will survive commerce clause scrutiny regardless of the extent to which the resource—or the tax—is exported and regardless of its rate. The central meaning of the Court's opinion, however, has less to do with the doctrinal considerations discussed in some detail in my more extensive written statement, than with institutional considerations which seem to be guiding the Court in delineating the scope of State tax power under the commerce clause. The Court has made it plain, especially in recent years, that its role in adjudicating State tax controversies is a limited one. The Court's adoption of a narrow role in this area is attributable to two critical institutional considerations. First, the Court is institutionally incapable of prescribing broad solutions to the vexing problems of State taxation of interstate commerce.

As the Special Subcommittee on State Taxation of Interstate Commerce of the House Judiciary Committee observed over 15 years ago:

> The inadequacy of the judicial process to deal with the problems of multistate taxation has long been recognized by members of the Supreme Court. In recent years, jurists with such varied philosophies as Justices Jackson, Rutledge, Black, Frankfurter, Douglas, and Clark have all subscribed to this view * * *.

Second, the Court is well aware that, in our constitutional scheme, its decisions under the commerce clause are tentative accommodations of State and national interests which are ultimately subject to revision by the Congress. The Court has consistently reaffirmed its view of the broad power of the Congress to draw whatever lines it believes are appropriate with respect to matters affecting interstate commerce. Indeed, in many of its recent decisions of refusing to invalidate State tax legislation under the commerce clause, the Court has invited the Congress to act if it is unhappy with the results flowing from the Court's hands-off attitude in this domain.

The Court's opinion in *Commonwealth Edison Co.* v. *Montana* relied heavily on these institutional considerations in refusing to strike down Montana's tax—and I quote:

> In the first place, it is doubtful whether any legal test could adequately reflect the numerous competing economic, geographic, demographic, social, and political considerations that must inform a decision about an acceptable rate or level of State taxation, and yet be reasonably capable of application in a wide variety of individual cases. But even apart from the difficulty of the judicial undertaking, the nature of the factfinding and judgment that would be required of the courts merely reinforces the conclusion that questions about the appropriate level of State taxes must be resolved through the political process. Under our Federal system, the determination is to be made by State legislatures in the first instance and, if necessary, by Congress when particular State taxes are thought to be contrary to Federal interests.

In short, the Court's decisions in cases like *Commonwealth Edison Co.* v. *Montana* do not, by any means, reflect a judgment that the taxing schemes the Court has sustained comport with its view of optimum or even sound national policy. Rather, they reflect a determination that the State, in the exercise of its essential taxing power, has not transcended any of the specific limitations which the commerce clause imposes on State taxation, and that the Court is institutionally incapable of going beyond such a judgment in adjudicating the constitutionality of such measures. Moreover, the Court knows, in adopting such a posture, that there is another branch of the Federal Government—the Congress—which is institutionally equipped and constitutionally empowered to forge more systematic and restrictive limitations on the power of the States to tax interstate commerce.

I now turn to the second issue I wish to address here today—congressional power under the commerce clause to limit State severance taxes. There are many complex, controversial, and sensitive issues surrounding the question whether Congress should limit State severance taxes. As I have already suggested, however, the existence of congressional power under the commerce clause to legislate in this area is not one of them. The Supreme Court made this clear in *Commonwealth Edison Co.* v. *Montana* by declaring that—

> The appropriate level of State taxes must be resolved through the political process * * * by State legislatures in the first instance and, if necessary, by Congress, when particular State taxes are thought to be contrary to Federal interests.

It may, nevertheless, be useful to summarize the governing principles in this area to remove or, at least, to clarify any doubts that may remain regarding Congress' power to limit State severance taxes under the commerce clause.

One need look no further than the Court's recently completed term to appreciate the Court's sweeping view of the scope of congressional power over matters that, in Congress' view, substantially affect interstate commerce. In *Hodel* v. *Virginia Surface Mining and Reclamation Association, Inc.*, the Court sustained the constitutionality of the Surface Mining Control and Reclamation Act of 1977 over the objection that the Congress had exceeded its power under the commerce clause in enacting it. In order to avoid unduly prolonging my oral statement, I shall quote only one of the passages from the Court's opinion that jointly and severely disposes of any contention that Congress lacks the power to legislate with respect to State severance taxes under the commerce clause.

> The task of a court that is asked to determine whether a particular exercise of congressional power is valid under the commerce clause is relatively narrow. The court must defer to a congressional finding that a regulated activity affects interstate commerce if there is any rational basis for such a finding. This established, the only remaining question for judicial inquiry is whether "the means chosen by [Congress] is reasonably adapted to the end permitted by the Constitution." The judicial task is at an end once the court determines that Congress acted rationally in adopting a particular regulatory scheme.

Moreover, the Court has frequently indicated that its broad view of congressional power under the commerce clause extends to State taxation of interstate commerce. Indeed, during its recently completed term, the Court had occasion to state flatly, in the course of an opinion sustaining a State insurance tax, that—

> Our decisions do not * * * limit the authority of Congress to regulate commerce among the several States as it sees fit.

In sum, if Congress were to find that State severance taxes imposed a burden on interstate commerce, it is virtually certain that the Court would find that the power to legislate with respect to such taxes lies within the affirmative grant of power to the Congress under the commerce clause.

The only decision that arguably casts doubt on the constitutionality under the commerce clause of congressional legislation limiting State severance taxes is *National League of Cities* v. *Usery*. In that case, a sharply divided Supreme Court held that Congress lacked the power under the commerce clause to prescribe minimum wages and maximum hours for State employees pursuant to the Fair Labor Standards Act. The Court made it clear that its opinion was not intended to disturb its "decisions establishing the breadth of authority granted to Congress under the commerce power." Rather, its holding was rooted in the constitutional policy, which is reflected in the 10th amendment, that

> * * * there are limits upon the power of Congress to override State sovereignty, even when exercising its plenary powers * * * to regulate commerce * * * conferred by Article I of the Constitution.

The Court concluded that in attempting to exercise its commerce power to prescribe minimum wages and maximum hours for the States in their sovereign capacities, Congress had "sought to wield its power in a fashion that would impair the States' 'ability to function effectively in a Federal system,'" and that Congress may not exercise its commerce power "so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made," or to threaten their separate and independent existence.

While it might be argued that the States' ability to employ severance taxes to finance their integral governmental functions is essential to their separate existence and any interference with such taxing power would impermissibly trench on State sovereignty, it is difficult to believe that congressional legislation limiting State severance taxes would raise a substantial constitutional issue under *National League of Cities* v. *Usery*, at least if such legislation did not absolutely prohibit such levies.

Cases decided subsequent to *National League of Cities* v. *Usery* support this view. In *Arizona Public Service Co.* v. *Snead*, the Court gave short shrift to the contention, evidently predicated on *National League of Cities* v. *Usery*, that Federal legislation limiting State taxation of electricity exceeded the bounds of congressional authority under the commerce clause.

The Court likewise evinced no concern in either the *Moorman* or *Mobil* cases that its invitation to Congress to legislate in the State tax field might be beset with *National League of Cities* v. *Usery* problems. Moreover, cases in the lower Federal courts construing the power of Congress under the commerce clause to limit State taxation of railroad property have squarely addressed and flatly rejected claims that Congress lacked the power to enact such legislation in light of *National League of Cities* v. *Usery*.

Scholarly commentary also supports the proposition that Congress possesses the power to legislate in this area notwithstanding *National League of Cities* v. *Usery*, although doubts have been expressed whether an absolute ban on such taxes would lie within Congress' commerce power.

Finally, and perhaps dispositively, the Supreme Court in *Commonwealth Edison Co.* v. *Montana* gave every indication that Congress possesses the power to limit State severance taxes without hinting that *National League of Cities* v. *Usery* might constitute a roadblock to such legislation.

One final caveat is in order regarding congressional power to limit State severance taxes. Just as the Court's decision sustaining Montana's severance tax should not be taken as an endorsement of the tax as a matter of sound national policy, neither should the existence of congressional power to limit such taxes be taken as a mandate for Congress to act in this area. As Chief Justice Marshall recognized, the States' "power of taxation is indispensable to their existence," and any efforts to limit this power should be treated as a matter of the greatest delicacy. If consumers are, in fact, bearing the burden of State severance taxes—an issue that is hardly free from doubt—and if Congress is concerned about this burden, then Congress should deal with the problem in an evenhanded way, assuming that it decides to deal with it all.

Although the commerce clause may not limit Congress' power to single out coal, for example, as the focus of rate limitation, if Congress is concerned about the burden of energy taxes on energy consumers, it would be hard—as a matter of interstate equity—to ignore severance taxes on oil or gas which may not impose equivalent cost burdens on the consumers of such energy.

Moreover, if Congress is concerned generally about State tax exportation—a subject Charles McLure can tell you much more about than I can—then perhaps Congress should focus on a wide variety of levies, such as Kentucky's tax on distilled spirits or New York's tax on theater admissions, before settling on the appropriate legislative solution to the problem.

In short, the truly difficult issues bearing on the question whether Congress should limit State severance taxes have to do with the wisdom of such legislation, not with the existence of the power to enact it.

Thank you.

Senator DURENBERGER. Thank you very much. Thank you for abbreviating a very thoughtful, longer statement.

Let me start with what the Court actually said. Do I understand your testimony to be that the Court found itself unable to determine whether or not the Montana tax was excessive rather than find that the tax was not excessive?

Mr. HELLERSTEIN. Surely the Court did not say the tax was not excessive, and it didn't address the issue of excessiveness except to say the issue of excessiveness is not a judicially cognizable problem under the commerce clause. I do think the Court indicated, in a footnote, that there are some limits on the excessiveness of taxes.

I think the idea of a 100-percent tax or a 1,000-percent tax would raise the issue of a tax being confiscatory. There is the due process clause which limits States from taking property without due process. Even though the commerce clause, in its wisdom, does not prevent Montana from imposing a 1,000-percent severance tax on coal, surely the due process clause would.

In addition, the Court notes the equal protection clause may come into play to limit the power of the States to discriminate against one industry. For example, if the State of Montana eliminated all taxes except those on the coal industry, again, there may be an issue which the appellants did not raise in the *Commonwealth Edison Co.* v. *Montana* case, of equal protection violations.

So while I agree the States are broadly free to impose severance taxes under the commerce clause, and indeed under these other provisions—equal protection and due process clause—there are some limits. I think the notion of a 100-percent or a 1,000-percent tax would trigger a judicial response.

Senator **Durenberger**. But the bottom line is that the ruling in the *Montana* case really deals much more with the proper role of the Court vis-a-vis the Congress than it does with proper taxing on the part of the States.

Mr. **Hellerstein**. Absolutely, I agree with that.

Senator **Durenberger**. You indicated in your statement that the Court for some time has been handing out these invitations to Congress to do something about State taxation as it relates to interstate commerce.

Mr. **Hellenstein**. Not only in the severance tax area but in the area of apportionment which raises difficult issues, not completely different from the ones we are addressing here.

Senator **Durenberger**. It is also true Congress has not accepted any of those invitations to date.

Mr. **Hellerstein**. Congress has, from time to time, imposed fairly specific limitations when it is dissatisfied with a particular Court decision. They have been narrow; 1959 is the first year in which the Congress legislated with respect to State taxation of interstate commerce. Congress didn't like the *Northwestern States* v. *Portland Cement* case, because it looked like a lot of small businesses were suddenly subject to the power of the States to tax them. So Congress came along and, in fact, imposed a nexus limitation—if you were going to be taxed, you had to be within the State beyond a certain threshold in terms of in-State activity.

Congress has more recently responded to the Court's decisions both in limiting the power of the States to impose user charges on air commerce, and in limiting the power of States to impose discriminatory taxes on railroad property. Congress now limits, in addition, the States' power to impose discriminatory taxes on motor carrier property.

Congress has, from time to time, legislated in this area—I think it is fair to say—but in a fairly narrow and specific framework.

Senator **Durenberger**. Let us get to the issue of the fourth prong of *Complete Auto Transit* test. You were here when I asked Mr.

Rogers a question relative to whether or not he was wrong or he was misunderstood. He indicated they have been following Justice Blackmun's lead, who has been writing consistently for the majority on this issue and now all of a sudden finds himself in the minority. Do you see this as a phenomenon that is isolated to severance taxes? Or, has there been some rather dramatic shift in the Court on the whole issue of reasonably related or as stated in the fourth prong?

Mr. HELLERSTEIN. I think the truth of the matter is that, until the appellants in the *Montana* case raised the issue, the Court had not squarely been confronted with precisely what it meant by "fairly related to the benefits provided by the State." The Court had used this language. If one goes back and looks at the cases, the only time one finds that the Court had actually engaged in any kind of quid pro quo determination was in cases involving user charges—where the State, in fact, imposes a fee or a charge as reimbursement for a specific State service.

The Court had used the language but no one, before the appellants in the *Montana* case, ever suggested that they would prove the tax was unfairly related to the services provided by the States. I think the Court had to confront what it meant by the language.

I would certainly agree with Mr. Rogers that his reading of the "fairly related" language is a plausible one, even though the Court indicated that it saw no reason why severance taxes should be limited to quantifiable services provided by the State in connection with the severance activities. In other words, why shouldn't severance taxes be permitted to contribute to the general cost of government? Nevertheless, I still would agree with Mr. Rogers generally. The Court, having made the determination that it was not going to get into this business of measuring quantifiable costs or services or benefits versus the tax, had to find some content they were willing to give this language.

I think the Court had never really been forced to give content to that fourth prong. Once it was forced to give content to the fourth prong, the content had to be consistent with its view that measuring costs and benefits against the level or the rate of a tax was not a proper judicial function.

Senator DURENBERGER. You can appreciate the difficulty of taking on this task that I tried to reflect in my question to Mr. Rogers. At the end of your statement, where you mentioned Chief Justice Marshall and ended up by saying "Mr. McLure will have something to add," you indicated that this is not an easy issue with which to deal.

Secretary Rogers said it is probably as easy as taking the percentage approach. He felt 12½ percent on coal—and, by indication, on either natural resources—would be reasonable.

In your opinion, is this task of applying the national interest through the interstate commerce clause to State severance taxation as simple as finding the right percentage?

Mr. HELLERSTEIN. I don't think it is as simple as finding the right percentage. You asked me a question that I thought was a hard one: Whether Congress should approach the issue as a matter of costs versus benefits or whether some kind of flat percentage would be preferable, assuming Congress has determined to act in this area.

Let me address each of those possible approaches. Let us assume that, after these hearings and with some evidence, you somehow identified the costs associated with a particular severance tax and decided to limit taxes to those costs. I would say you ought to take into account the fact, or the problem, that all States have a diverse tax structure. I would hesitate to limit the States entirely with respect to any kind of a tax to the specific costs imposed on the taxpayer. In other words, why should a particular kind of tax not be permitted to contribute, maybe within a reasonable limit, to the general cost of the government?

Maybe Congress wants to legislate—I think it probably has the power to do so—and says, "Look, certain kinds of taxes are just too risky with respect to tax exportation. We are going to limit the taxes which are permitted to be used for general revenue to general income taxes, ad valorem property taxes, whatever." I think that is taking a rather instrusive step into the present structure of State taxing systems. I would, at least, urge that there be some kind of leeway, even if one took this cost-based approach, for allowing some margin for contributing to general governmental costs, even if the taxpayer didn't impose those costs, or even if the taxpayer wasn't given specific services which could be justified by the tax.

I think the percentage approach is a neater way of doing it. However, I don't know how you are going to determine the right percentage. In the end, I suppose you will have to look to costs of some sort. Maybe, again, I would urge that there be some margin here. If the percentage approach was taken, then perhaps 12½ percent would so far exceed anything that relates to cost, you would be incorporating a margin of percentage. That is the other consideration I would urge.

In other words, there should not be a strict limitation to costs or services with respect to any tax because, as the Court points out, a basic principle of taxation is that taxes do provide for the common benefit. Often the taxpayer can't show that he has derived any benefit directly or indirectly from a particular tax which is levied.

Senator **Durenberger**. Thank you very much. Having pointed out the difficulty of the problem, I hasten to say this is only the starting process and not the end. I hope the difficulty doesn't discourage anyone from continuing on this course. We appreciate your contributions to date and hope you will be available to this subcommittee in the future.

Mr. **Hellerstein**. I certainly will be.

[The prepared statement of Mr. Hellerstein follows:]

UNITED STATES SENATE COMMITTEE
ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS

"Fiscal Disparities, Part II: The Commerce Clause and State Severance Taxes"

Testimony of Walter Hellerstein

July 15, 1981

I am Walter Hellerstein, Associate Professor, University of Georgia School of Law. My principal area of academic interest is state and local taxation, and I have devoted special attention in the last few years to the federal constitutional issues associated with state taxation of energy.[1] I am pleased and honored by the Subcommittee's invitation to testify on the Commerce Clause and state severance taxes. At the outset, I wish to disclose that I have consulted with the State of Montana in connection with Commonwealth Edison Co. v. Montana,[2] in which the Supreme Court sustained Montana's coal severance tax over Commerce Clause and Supremacy Clause objections. The views expressed here, of course, are entirely my own and do not necessarily represent those of Montana.[3]

My remarks are directed primarily to two questions bearing on the relationship of the Commerce Clause to state severance taxes. First, where do the Court's recent decisions and, particularly, its decision in Commonwealth Edison Co. v. Montana, leave the state of the law regarding the restraints that the Commerce Clause, by its own force, imposes on state severance taxes? Second, assuming that Congress determined to exercise its power under the Commerce Clause to limit state severance taxation, would such an exercise of congressional power be constitutional?

I. THE NEGATIVE IMPLICATIONS OF THE COMMERCE CLAUSE AND STATE SEVERANCE TAXES

A. General Principles of Commerce Clause Adjudication

The Commerce Clause by its terms is no more than an affirmative grant of power to Congress "to regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes."[4] Nevertheless, from the beginning of our constitutional history the United States Supreme Court elaborated the view that "became central to our whole constitutional scheme: the doctrine that the commerce clause, by its own force and without national legislation, puts it into the power of the Court to place limits upon state authority."[5] Through hundreds of opinions handed down over the past century and a half, the Supreme Court has attempted to delineate the implied limitations that the Commerce Clause imposes on state taxing and regulatory power. It is now generally understood that in undertaking this task the Court is engaged in a delicate balancing of state and national interests to determine the appropriate accommodation between the competing demands of national economic unity and legitimate state policy.

In reviewing state tax legislation that allegedly offends these negative implications of the Commerce Clause, the Court in recent years has articulated with clarity and consistency the criteria that control the validity of state taxes affecting interstate commerce. Proceeding from the underlying premises that the states should generally be accorded broad leeway in the exercise of their taxing authority and that interstate commerce should pay its way, the Court has repeatedly declared that it will sustain state taxes over Commerce Clause objections so long as the taxes satisfy four criteria. First, the tax must be applied to an activity that has a substantial nexus with the state.[6] Second, the tax must be fairly apportioned to activities carried on by the taxpayer in the state.[7] Third, the tax must not discriminate against interstate commerce.[8] And fourth, the tax must be fairly related to services provided by the state.[9]

With regard to state severance taxes---taxes imposed on the extraction of natural resources and measured by the value or quantity of the resource extracted---there has never been much doubt that such taxes satisfied the first two prongs of the Court's Commerce Clause standard. The Court's nexus criterion requires that there be "some definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax."[10] As the Supreme Court stated in Commonwealth Edison Co. v. Montana with reference to Montana's coal severance tax, "there can be no argument here that a substantial, in fact, the only nexus of the severance of coal is established in Montana."[11] Nor has the Court's fair apportionment criterion, which has generated considerable constitutional conflict over state income taxation of multijurisdictional enterprises,[12] given rise to serious disputes in the context of state severance taxation. As the Supreme Court observed in the Montana severance tax case, there can be no question of unfair apportionment and, consequently, of an unconstitutional risk of multiple taxation, because "'the severance can occur in no other state' and 'no other state can tax the severance.'"[13]

The focus of contemporary Commerce Clause controversy over state severance taxes has been on the other two criteria---that a tax not discriminate against interstate commerce and that it be fairly related to services provided by the taxing state. The Court's opinion in Commonwealth Edison Co. v. Montana sheds considerable light on the application of these criteria to state severance taxes.

1. Taxes Discriminating Against Interstate Commerce

The rule prohibiting state taxes discriminating against interstate commerce has been a fundamental tenet of the Court's

Commerce Ckause doctrine from the very beginning.[14] Although the concept of discrimination is not self-defining and the scope of the doctrine forbidding discriminatory taxes has never been precisely delineated by the Court, the central meaning of discrimination as a criterion for adjudicating the constitutionality of state taxes on interstate commerce emerges unmistakably from the Court's numerous decisions addressing the issue: a tax which by its terms or operation imposes greater burdens on out-of-state goods or activities than on competing in-state goods, or activities will be struck down as discriminatory under the Commerce Clause.

The claim that a state severance tax discriminates against interstate commerce does not fit neatly within the Court's traditional doctrine. Severance taxes are generally nondiscriminatory on their face, applying to every ton of coal or barrel of oil or cubic foot of gas extracted in the state. No distinction is drawn in such taxing schemes between local and out-of-state interests: the burden of the tax is borne according to the amount of the coal, oil, or gas produced or, if the tax is shifted forward, according to the amount consumed, without regard to the residence of the producer or the consumer.

The claim that a severance tax discriminates against interstate commerce, however, is predicated on two interrelated propositions that arguably bring the case within the Court's proscription against discriminatory levies. First, it is contended that such a tax is in fact borne largely by out-of-state consumers, a fact that depends on whether the tax is exported along with the resource. Second, it is alleged that the amount of the tax exceeds the costs imposed on and benefits provided by the state in connection with the extraction of the resource. The second contention is a necessary element of the Commerce Clause argument because the states do not violate the Commerce Clause when they demand from those consuming their resources reimbursement for a fair share of such costs and benefits. Interstate commerce, the Court has frequently reminded us, must pay its way.[15]

The argument, as I have stated it elsewhere, thus boils down to the proposition that:

> a State in a position to exact a levy on its energy resources that is passed on to out-of-state consumers violates the Commerce Clause when it imposes a tax greater than that necessary to recoup the costs associated with the extraction of that resource from the State. As thus narrowed, the argument has considerable force. Putting aside for the moment the formidable evidentiary problems involved in proving such a case, one may fairly contend that the State's effective selection of a class of out-of-state taxpayers to shoulder a tax burden grossly in excess of any costs imposed directly or indirectly by such taxpayers on the State places an unconstitutional burden upon interstate commerce. For the Court has made it clear that facially nondiscriminatory taxes which by their practical operation discriminate against interstate commerce are vulnerable to attack on Commefce Clause grounds. While the States need not fine-tune the exercise of their taxing power to accord with a precise accounting of the costs imposed by and benefits provided to the taxpayer, they should not be permitted to single out the nonresident taxpayer to bear the brunt of a demonstrable imbalance on this score, at least if it can be shown that other

> levies with a less selective impact do not suffer from such an imbalance.[16]

Needless to say, it was the dissenting opinion in Commonwealth Edison Co. v. Montana that relied on the abovequoted excerpt from my article.[17] The majority found the argument unpersuasive for several reasons. First, it adverted to the difficulties involved were it confronted with the task of "judging the validity of a state tax by assessing the State's 'monopoly' position or its 'exportation' of the tax burden out of the State."[18] Second, it observed that the premise underlying its Commerce Clause decisions was that state borders are irrelevant and that to "invalidate the Montana tax solely because most of Montana's coal is shipped across the very state borders that ordinarily are to be considered irrelevant would require a significant and . . . unwarranted departure from the rationale of our prior discrimination cases."[19] Third, the Court was unwilling to characterize as discriminatory a tax which treated residents and nonresidents alike, even if its effect was to deny nonresidents access to another state's resources at "reasonable" prices.[20] Finally, and, in my judgment, most importantly, the Court recognized that the

> appellants' discrimination theory ultimately collapses into their claim that the Montana tax is invalid under the fourth prong of the [Court's] test: that the tax is not "fairly related to the services provided by the State." Because appellants concede that Montana may impose *some* severance tax on coal mined in the State, the only remaining foundation for their discrimination theory is a claim that the tax burden borne by the out-of-state consumers of Montana coal is excessive. This is, of course, merely a variant of appellants' assertion that the Montana tax does not satisfy the "fairly related" prong of the [Court's] test . . .21

Before turning to the application of the fourth prong of the Court's Commerce Clause test to state severance taxes, I believe two final comments regarding the discrimination criterion are warranted. First, one may fairly conclude from Commonwealth Edison Co. v. Montana that a typical state severance tax imposed on the extraction of a resource in a state and measured by the amount or value of the resource extracted is invulnerable to attack on the grounds that it discriminates against interstate commerce, regardless of the extent to which the resource (or the tax) is exported and regardless of the rate or amount of the tax. Second, it does not follow from this conclusion that the Court is insensitive to claims of state tax discrimination under the Commerce Clause. Less than six weeks before it handed down the Montana decision, the Court in Maryland v. Louisiana,[22] struck down Louisiana's "First Use Tax" on natural gas in part on the ground that it discriminated against interstate commerce. The Court found that the tax violated "the fundamental principl[e] . . . that no State consistent with the Commerce Clause may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'"[23] The Court found that the Louisiana scheme favored local over out-of-state interests in a number of respects---for example, by granting credits and exemptions that were available only to local producers and consumers---and thus could not survive Commerce Clause scrutiny. This suggests that the Court's unwillingness to brand as discriminatory a tax like Montana's should not be viewed as a relaxation of the Court's traditional vigilance in adjudicating claims that a state tax discriminates against interstate commerce---at least when the claim is rooted in an allegation that a tax provides a competitive advantage to in-state over out-of-state interests.

2. Fair Relation Between a Tax and Services Provided by the State

The fourth prong of the Court's Commerce Clause test---that a tax be "fairly related to services provided by the State"---has ostensibly been the most powerful predicate of a Commerce Clause challenge to state severance taxes. If the Commerce Clause requires that there be a reasonable quantitative relationship between a state tax and the services provided to the taxpayer by the state,[24] and if severance taxpayers can prove their allegations that severance taxes far exceed any benefits provided or costs incurred by the state, then severance taxpayers have indeed raised a substantial Commerce Clause issue.

As the Court held in Commonwealth Edison Co. v. Montana, however, the major premise of the taxpayers' Commerce Clause syllogism was false. The "fairly related" test does not impose a requirement that the amount of a tax bear some quantitative relationship to the value of services provided by the state to the taxpayers. It requires only that "the measure of the tax must be reasonably related to the extent of the [taxpayer's] contact [with the State], since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of state tax burden.'"[25]

In light of this reading of the "fairly related" criterion, the Court in Commonwealth Edison Co. v. Montana had little difficulty in concluding that Montana's severance tax satisfied it.

> The "operating incidence" of the tax is on the mining of coal within Montana. Because it is measured as a percentage of the value of the coal taken, the Montana tax is in "proper proportion" to appellants' activities within the State and, therefore, to their "consequent enjoyment of the opportunities and protections which the State has afforded" in connection to those activities. When a tax is assessed in proportion to a taxpayer's activities or presence in a State, the taxpayer is shouldering its fair share of supporting the State's provision of "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.'"[26]

The Court justified its narrow construction of the "fairly related" test on a number of grounds. It distinguished cases involving user charges imposed as compensation for specific state-provided services, in which it had required that the fees in question be commensurate with the services provided, from an exaction like Montana's which was "imposed for the general support of government."[27] It recited its long-standing rule, articulated in the Due Process context, that

> [n]othing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.
>
> A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of

> taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government---that it exists primarily to provide for the common good.28

The Court saw no reason why the salutary principle loses its force

> merely because the taxed activity has some connection to interstate commerce . . . To accept appellants' apparent suggestion that the Commerce Clause prohibits the States from requiring an activity connected to interstate commerce to contribute to the general cost of providing governmental services, as distinct from those costs attributable to the taxed activity, would place such commerce in a privileged position. But as we recently reiterated, "'[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.'" The "just share of state tax burden" includes sharing in the cost of providing "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.'"29

Moreover, the Court found nothing in its prior cases to suggest that the relevant inquiry under the "fairly related" test is "the amount of the tax or the value of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities."[30]

In the end, however, it was not the language or holdings of its precedents that, in my judgment, led the Court to reject the taxpayers' contention that the "fairly related" test should be construed to require "a factual inquiry into the relationship between the revenues generated by a tax and the costs incurred on account of the taxed activity, in order to provide a mechanism for judicial disapproval under the Commerce Clause of state taxes that are excessive."[31] Rather, it was the Court's view of its proper role in adjudicating state tax controversies that was the motive force in its decision. The taxpayers had conceded, after all, that Montana's severance tax would have passed constitutional muster at some, unspecified lower rate. By arguing that the tax at its existing rate violated the "fairly related" criterion of the Commerce Clause, the taxpayers were inescapably seeking a judicial determination of the appropriate rate of a state tax. The Court's response to the taxpayers' efforts was unequivocal:

> The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial resolution. In essence, appellants ask this Court to prescribe a test for the validity of state taxes that would require state and federal courts to calculate acceptable rates or levels of taxation of activities that are conceded to be legitimate subjects of taxation. This we decline to do.32

Before concluding this section of my testimony, I will again venture two final observations. First, as in the case of the discrimination criterion, one may fairly conclude from Commonwealth Edison Co. v. Montana that a typical state severance tax is invulnerable to a Commerce Clause attack on the ground that it is not fairly related to services provided by the state, since the measures of such taxes, which are invariably based on the quantity or value of the resource extracted, are related to the extent of the taxpayers' activities in the state. Second, the Court's refusal to review state severance taxes for excessiveness under the "fairly related" criterion stems from its fundamental conviction that determining the rate or amount of a state tax is not an appropriate judicial function.

B. The Role of the Court in Adjudicating State Tax Controversies Under the Commerce Clause

The Court's opinion in Commonwealth Edison Co. v. Montana makes it clear that a typical state severance tax will survive Commerce Clause scrutiny regardless of the extent to which the resource (or the tax) is exported and regardless of its rate or amount.[33] The central meaning of the Court's opinion, however, has less to do with the doctrinal considerations discussed above than with institutional considerations that seem to be guiding the Court in delineating the scope of state tax power under the Commerce Clause. The Court has made it plain, especially in recent years, that its role in adjudicating state tax controversies is a limited one.[34] The Court's adoption of a narrow role in this area is attributable to two critical institutional considerations. First, the Court is institutionally incapable of prescribing broad solutions to the vexing problems of state taxation of interstate commerce. As Justice Frankfurter has stated:

> At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the in-

> cidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.[35]

As the Special Subcommittee on State Taxation of Interstate Commerce of the House Judiciary Committee observed over fifteen years ago: "The inadequacy of the judicial process to deal with the problems of multistate taxation has long been recognized by members of the Supreme Court. In recent years, jurists with such varied philosophies as Justices Jackson, Rutledge, Black, Frankfurter, Douglas, and Clark, have all subscribed to this view . . ."[36]

Second, the Court is well aware that in our constitutional scheme its decisions under the Commerce Clause are tentative accommodations of state and national interests that are ultimately subject to revision by Congress.[37] The Court has consistently reaffirmed its view of the broad power of Congress to draw whatever lines it believes are appropriate with respect to matters affecting interstate commerce.[38] Indeed, in many of its recent decisions refusing to invalidate state tax legislation under the Commerce Clause, the Court has invited Congress to act if it is unhappy with the results flowing from ~~its~~ the Court's hands-off attitude in this domain. In Moorman Manufacturing Co. v. Bair,[39] the Court, in declining to prescribe a uniform apportionment formula governing the division of income from interstate business, stated:

> While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.[40]

Likewise in Mobil Oil Corp. v. Commissioner of Taxes,[41] in which the Court rejected a constitutional challenge to Vermont's taxation of an apportioned share of Mobil's foreign source dividends, the Court observed: "Congress in the future may see fit to enact legislation requiring a uniform method for state taxation of foreign dividends. To date, however, it has not done so."[42]

The Court's opinion in Commonwealth Edison Co. v. Montana relied heavily on these institutional considerations in refusing to strike down Montana's tax:

> In the first place, it is doubtful whether any legal test could adequately reflect the numerous competing economic, geographic, demographic, social, and political considerations that must inform a decision about an acceptable rate or level of state taxation, and yet be reasonably capable of application in a wide variety of individual cases. But even apart from the difficulty of the judicial undertaking, the nature of the factfinding and judgment that would be required of the courts merely reinforces the conclusion that questions about the appropriate level of state taxes must be resolved through the political process. Under our federal system, the determination is to be made by state legislatures in the first instance and, if necessary, by Congress when particular state taxes are thought to be contrary to federal interests.[43]

In short, the Court's decisions in cases like Commonwealth Edison Co. v. Montana do not by any means reflect a judgment that the taxing schemes the Court has sustained comport with its view of optimum or even sound national policy. Rather they reflect a determination that the state, in the exercise of its essential taxing power, has not transcended any of the specific limitations that the Commerce Clause imposes on state taxation and that the Court is institutionally incapable of going beyond such a judgment in adjudicating the constitutionality of such measures. Moreover, the Court knows in adopting such a posture that there is another branch of the Federal Government---the Congress---that is institutionally equipped and constitutionally empowered to forge more systematic and restrictive limitations on the power of the states to tax interstate commerce, if Congress is so minded.

II. CONGRESSIONAL POWER UNDER THE COMMERCE CLAUSE TO LIMIT STATE SEVERANCE TAXES

There are many complex, controversial, and sensitive issues surrounding the question whether Congress should limit state severance taxes. As I have already suggested, however, the existence of congressional power under the Commerce Clause to legislate in this area is not one of them. The Supreme Court made this clear in Commonwealth Edison Co. v. Montana by declaring that "the appropriate level of state taxes must be resolved through the political process . . . by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests."[44] It may nevertheless be useful to summarize the governing principles in this area to remove or, at least, to clarify any doubts that may remain regarding Congress' power to limit state severance taxes under the Commerce Clause.

A. The Scope of Congressional Power Under the Commerce Clause

From the very beginning, the Supreme Court indicated that the scope of congressional power under the Commerce Clause was extremely broad. In the seminal opinion of Gibbons v. Ogden,[45] Chief Justice Marshall "described the federal commerce power with a breadth never yet exceeded."[46] The comprehensive meaning that Marshall gave to the grant to Congress "[t]o regulate Commerce . . . among the several States,"[47] included "every species of commercial intercourse" concerning "more States than one."[48] While there were periods during our constitutional history when the Court's opinions did not fully reflect this expansive view of the congressional commerce power, the Court ultimately returned to the ancient moorings of Gibbons v. Ogden and fully embraced the sweeping view of the congressional commerce power that characterizes its contemporary Commerce Clause jurisprudence.[49]

One need look no further than the Court's recently completed term to appreciate just how sweeping that view is. In Hodel v.

Virginia Surface Mining and Reclamation Association, Inc., the Court sustained the constitutionality of the Surface Mining Control and Reclamation Act of 1977 over the objection that Congress had exceeded its power under the Commerce Clause in enacting it. Extended quotation from the Court's opinion is warranted because it would seem to dispose of any contention that Congress lacks the power to legislate with respect to state severance taxes under the Commerce Clause:

> The task of a court that is asked to determine whether a particular exercise of congressional power is valid under the Commerce Clause is relatively narrow. The court must defer to a congressional finding that a regulated activity affects interstate commerce if there is any rational basis for such a finding. This established, the only remaining question for judicial inquiry is whether "the means chosen by [Congress] is reasonably adapted to the end permitted by the Constitution." The judicial task is at an end once the court determines that Congress acted rationally in adopting a particular regulatory scheme.
>
> Judicial review in this area is influenced above all by the fact that the Commerce Clause is a grant of plenary authority to Congress. This power is "complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the constitution." Moreover, this Court has made clear that the commerce power extends . . . to "activities affecting commerce." . . . "[e]ven activity that is purely intrastate may be regulated by Congress, where the activity, combined with like conduct by others similarly situated, affects commerce among the States or with foreign nations."
>
> Thus, when Congress has determined that an activity affects interstate commerce, the courts need inquire only whether the finding is rational. . . .
>
> . . . .
>
> The denomination of an activity as a "local" or "intrastate" activity does not resolve the

> question whether Congress may regulate it under the Commerce Clause. As previously noted, the commerce power "extends to those activities intrastate which so affect interstate commerce, or the exertion of the power of Congress over it, as to make regulation of them appropriate means to the attainment of a legitimate end, the effective execution of the granted power to regulate interstate commerce. . . . Appellees do not dispute that coal is a commodity that moves in interstate commerce. Here, Congress rationally determined that regulation of surface coal mining is necessary to protect interstate commerce from adverse effects that may result from that activity. This congressional finding is sufficient to sustain the Act as a valid exercise of Congress' power under the Commerce Clause.51

If this were not enough, the Court has frequently indicated that its broad view of congressional power under the Commerce Clause extends to state taxation of interstate commerce. Some of these statements have already been alluded to above.[52] The Court has also observed that "[t]he power of Congress to grant protection to interstate commerce against state regulation or taxation . . . is so complete that its ideas of policy should prevail."[53] It has noted that "Congress through the Commerce Clause possesses the . . . power of control of state taxation of all merchandise moving in interstate or foreign commerce."[54] It has remarked that its task of delineating the negative restraints that the Commerce Clause imposes on state tax power must be undertaken only "so long as Congress does not undertake to make specific arrangements between the National Government and the States in regard to revenues from interstate commerce."[55]

Finally, during its recently completed term, the Court had occasion to state flatly, in the course of an opinion sustaining a state insurance tax, that "[o]ur decisions do not . . . limit the authority of Congress to regulate commerce among the several States as it sees fit."[56]

In sum, if Congress were to find that state severance taxes imposed a burden on interstate commerce, it is virtually certain that the Court would find that the power to legislate with respect to such taxes lies within the affirmative grant of power to Congress under the Commerce Clause.

B. Affirmative Limitations on the Scope of Congressional Power Under the Commerce Clause

The only decision that arguably casts doubt on the constitutionality under the Commerce Clause of congressional legislation limiting state severance taxes is National League of Cities v. Usery.[57] In that case, a sharply divided Supreme Court held that Congress lacked the power under the Commerce Clause to prescribe minimum wages and maximum hours for state employees pursuant to the Fair Labor Standards Act. The Court made it clear that its opinion was not intended to disturb its "decisions establishing the breadth of authority granted to Congress under the commerce power."[58] Rather, its holding was rooted in the constitutional policy, which is reflected in the Tenth Amendment, that "there are limits upon the power of Congress to override state sovereignty, even when exercising its plenary powers . . . to regulate commerce . . . . conferred by Art. I of the Constitution."[59] The Court concluded that in attempting to exercise its commerce power to prescribe minimum wages and maximum hours for the states in their sovereign capacities, Congress had "sought to wield its power in a fashion that would impair the States' 'ability to function effectively in a federal system,'"[60] and that Congress may not exercise its commerce power "so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made."[61]

Examination of National League of Cities as well as cases that have been decided more recently suggests that Congress is still free within broad limits to legislate with respect to state severance taxes under the Commerce Clause. The basic predicate of the Court's decision is that Congress may not exercise power it otherwise possesses under the Commerce Clause so as to impair the states' ability to function effectively in a federal system or so as to force upon the states Congress' choice in the making of essential decisions regarding the conduct of integral governmental functions. In concluding that the congressional wages and hours legislation would have such an impermissible impact on the states, the Court emphasized that the legislation would impose "increased costs . . .[with] a significant impact on the functioning of the governmental bodies involved";[62] cause "forced relinquishment of important governmental activities"[63]; "displac[e] state policies regarding the manner in which they will structure delivery of those governmental services which their citizens require,"[64]; and "coerc[e] the States to structure work periods in some employment areas . . . in a manner substantially different from practices which have long been commonly accepted among local governments of this Nation."[65] It was on the basis of factors such as these that the Court determined that the congressional legislation will "significantly alter or displace the States' abilities to structure employer-employee relationships in such areas as fire prevention, police protection, sanitation, public health, and parks and recreation."[66] And this determination underlies the Court's ultimate conclusion that Congress, by imposing minimum wages and maximum hours requirements on the states, had sought to exercise its power in such a manner as to threaten the states' "separate and independent existence."[67]

While it might be argued that the states' ability to employ severance taxes to finance their integral governmental functions is essential to their separate existence and any interference with such taxing power would impermissibly trench on state sovereignty, it is difficult to believe that congressional legislation limiting state severance taxes would raise a substantial constitutional issue under *National League of Cities*, at least if such legislation did not absolutely prohibit such levies.[68] Cases decided subsequent to *National League of Cities* support this view. In *Arizona Public Service Co*. v. *Snead*,[69] the Court gave short shrift to the contention, evidently predicated on *National League of Cities*, that federal legislation limiting state taxation of electricity exceeded the bounds of congressional ~~action~~ authority under the Commerce Clause:

> In view of the broad power of Congress to regulate interstate commerce, this argument must be rejected. Here, the Congress had a rational basis for finding that the New Mexico tax interfered with interstate commerce, and selected a reasonable method to eliminate that interference. The legislation

> thus was within the constitutional power of Congress to enact.[70]

The Court likewise evinced no concern in either the Moorman or Mobil case[71] that its invitation to Congress to legislate in the state tax field might be beset with National League of Cities problems. Moreover, cases in the lower federal courts construing the power of Congress under the Commerce Clause to limit state taxation of railroad property have squarely addressed and flatly rejected claims that Congress lacked the power to enact such legislation in light of National League of Cities.[72] Scholarly commentary also supports the proposition that Congress possesses the power to legislate in this area notwithstanding National League of Cities,[73] although doubts have been expressed whether an absolute ban on such taxes would lie within Congress' commerce power.[74] Finally, and, perhaps, dispositively, the Supreme Court in Commonwealth Edison Co. v. Montana gave every indication that Congress possesses the power to limit state severance taxes without hinting that National League of Cities might constitute a roadblock to such legislation. In declaring that the appropriate level of state taxes may be established "if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests,"[75] the Court explicitly noted the fact that "the controversy over the Montana tax has not escaped the attention of Congress,"[76] and referred to legislation that has been introduced in Congress "to limit the rate of state severance taxes."[77]

C. Prudential Considerations

One final caveat is in order regarding congressional power to limit state severance taxes. Just as the Court's decision sustaining Montana's severance tax should not be taken as an an endorsement of the tax as a matter of sound national policy neither should the existence of congressional power to limit such taxes be taken as a mandate for Congress to act in this area. As Chief Justice Marshall recognized, the states' "power of taxation is indispensable to their existence,"[78] and any efforts to limit this power should be treated as a matter of the greatest delicacy. If consumers are in fact bearing the burden of state severance taxes, an issue that is hardly free from doubt, and if Congress is concerned about this burden, then Congress should deal with the problem in an evenhanded way, assuming that it decides to deal with it at all. Although the Commerce Clause may not limit Congress' power to single out coal, for example, as the focus of rate limitation,[79] if Congress is concerned about the burden of energy taxes on energy consumers it would be hard, as a matter of interstate equity, to ignore severance taxes on oil or gas which may impose equivalent cost burdens on the consumers of such energy. Moreover, if Congress is concerned generally about state tax exportation---a subject Charles McLure can tell you much more about than I can[80]---then perhaps Congress should focus on a wide variety of levies (such as Kentucky's tax on distilled spirits or New York's tax on theater admissions) before settling on the appropriate legislative solution to the problem. In short, the truly difficult issues bearing on the question whether Congress should limit state severance taxes have to do with the wisdom of such legislation not with the existence of the power to enact it.

Footnotes

1. See, e.g., W. Hellerstein, State Taxation in the Federal System: Perspectives on Louisiana's First Use Tax on Natural Gas, Shell Foundation Lecture at Tulane University Law School (Nov. 20, 1980), to be published in 55 Tul. L. Rev. No. 3 (Spring. 1981); W. Hellerstein, Constitutional Constraints on State and Local Taxation of Energy Resources, 31 Nat. Tax J. 245 (1978).

2. ___ U.S. ___ (July 2, 1981) (Slip.Op.).

3. Indeed, they almost certainly do not represent the views of Montana.

4. U.S. Const. art. I, §8, cl. 3.

5. F. Frankfurter, The Commerce Clause under Marshall, Taney, and Waite 18 (Quadrangle Paperback ed. 1964).

6 See Commonwealth Edison Co. v. Mont., ___ U.S. ___ (July 2, 1981) (Slip. Op., p. 6); Maryland v. Louisiana, 49 U.S.L.W. 4562, 4570 (U.S., May 26, 1981); Exxon Corp. v. Wisconsin Department of Revenue, 100 S.Ct. 2109, 2122 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443 (1980); Japan Lines, Ltd. v. County of Los Angeles, 441 U.S. 434, 444-45 (1979);

Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734, 750 (1978); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 287 (1977); Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975).

7. *Id*.

8. *Id*.

9. *Id*.

10. Miller Bros. v. Maryland, 347 U.S. 340, 344-45 (1954). While *Miller Brothers* was decided under the Due Process clause, the nexus requirement has also been incorporated into the Court's Commerce Clause jurisprudence. See note 6 *supra*.

11. Commonwealth Edison Co. v. Montana, ___ U.S. ___ (July 2, 1981) (Slip. Op., p. 6) (Quoting Commonwealth Edison Co. v. State, ___ Mont. ___, ___, 615 P.2d 847, 855 (1980).

12. *See*, *e.g.*, Exxon Corp. v. Wisconsin Department of Revenue, 100 S.Ct. 2109 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 4~~0~~45 U.S. 425 (1980); W. Hellerstein, *State Income Taxation of Multijurisdictional Corporations*: *Reflections on Mobil, Exxon, and H. R. 5076*, 79 Mich L. Rev. 113 (1980).

13. Commonwealth Edison Co. v. Montana, ___ U.S. ___ (July 2, 1981) (Slip. Op., p. 6) (Quoting Commonwealth Edison Co. v. State, ___ Mont. ___, ___, 615 P.2d 847, 855 (1980)). For a discussion of the multiple taxation doctrine, see W. Hellerstein, *supra* note 12, at 130-35.

14. See Welton v. Missouri, 91 U.S. 275 (1876).

15. *See*, *e.g.*, Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

16. W. Hellerstein, *Constitutional Constraints on State and Local Taxation of Energy Resources*, 31 Nat. Tax J. 245, 249 (1978).

17. Commonwealth Edison Co. v. Montana, ___ U.S. ___ (July 2, 1981) (Blackmun, J. dissenti~~en~~ng) (Slip.Op. 13-14).

18. *Id*. (Slip. Op.,p. 7)

19. *Id*. (Slip. Op., p. 7-8).

20. *Id*. (Slip. Op., p. 8).

21. *Id*. (Slip. Op., p. 9) (citations omitted).

22. 49 U.S.L.W. 4562 (U.S., May 26, 1981).

23. *Id*. at 4570 (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)).

24. On the assumption that the tax in question substantially affects interstate commerce. See Part II *infra*.

25. Commonwealth Edison Co. v. Montana, ___ U.S. ___ (July 2, 1981) (Slip. Op., p. 15).

26. *Id*.

27. *Id*. at 10-11 (quoting Commonwealth Edison Co. v. State, ___ Mont. ___, 615 P.2d at 856).

28. *Id*. at 11-12 (quoting Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 521-22 (1937)).

29. *Id*. at 12. (citations omitted).

30. *Id*. at 14. (emphasis in original).

31. *Id*. at 16.

32. *Id*. at 16-17 (citations omitted)

33. Under some circumstances, however, there may be other constitutional grounds for attacking state severance taxes, such as a denial of Due Process or Equal Protection. See Commonwealth Edison Co. v. Montana, ___ U.S. ___ (July 2, 1981) (Slip. Op., p. 16 16 & 17).

34. *See*, *e.g*., Exxon Corp. v. Wisconsin Department of Revenue, 100 S.Ct. 2109 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); Moorman Mfg. Co. v. Bair, 437 U.S.267 (1978); Washington Revenue Dept. v. Stevedoring Assn., 435 U.S. 734 (1978); National Geographic Socy. v. State Bd. of Equalization,

430 U.S. 551 (1977); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976).

35. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 476 (1959) (Frankfurter, J, dissenting).

36. Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary, State Taxation of Interstate Commerce, H.R. Rep. No. 1480, 88th Cong. 2d Sess. 13 (1964).

37. See Brown, The Open Economy: Justice Frankfurter and the Position of the Judiciary, 67 Yale L.J. 219 (1957).

38. See, e.g., Southern Pacific Co. v. Arizona, 325 U.S. 761 769 (1945); Cloverleaf Butter Co. v. Patterson, 315 U.S. 148, 155-56 (1942); South Carolina State Highway Department v. Barnwell Brothers, Inc., 303 U.S. 177, 189-90 (1938).

39. 437 U.S. 267 (1978).

40. Id. at 280.

41. 445 U.S. 425 (1980).

42. Id. at 449.

43. ___ U.S. ___ (Slip Op., p. 17).

44. *Id*.

45. 22 U.S. (9 Wheat.) 1 (1824).

46. Wickard v. Filburn, 317 U.S. 11, 120 (1942).

47. U.S. Const. art I, § 8, cl. 3.

48. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 193-94 (1824).

49. *See, e.g.*, Perez v. United States, 402 U.S. 146 (1971); Katzenbach v. McClung, 379 U.S. 294 (1964); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964); Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Darby, 312 U.S. 100 (1941).

50. 49 U.S.L.W. 4654 (U.S., June 15, 1981).

51. *Id*. at 4656-58.

52. See text at notes 38-43 *supra*.

53. State Board of Insurance v. Todd Shipyards Corp., 370 U.S. 451, 456 (1962).

54. Hooven & Allison Co. v. Evatt, 324 U.S. 652, 679 (1945).

55. Freeman v. Hewit, 329 U.S. 249, 254 (1946).

56. Western & Southern Life Insurance Co. v. State Board of Equalization, 49 U.S.L.W. 4542, 4543 (U.S., May 26, 1981).

57. 426 U.S. 833 (1976).

58. Id. at 841.

59. Id. at 842.

60. Id. at 852.

61. Id. at 855.

62. Id. at 846.

63. Id. at 847.

64. Id.

65. Id. at 850.

66. Id. at 851.

67. Id. at 845, 851.

68. See Browde and DuMars, State Taxation of Natural Resource Extraction and the Commerce Clause: Federalism's Modern Frontier, 60 Ore. L. Rev. 7, 54-56 & n. 288 (1981)(concluding that Congress possesses the power to limit state severance taxes despite National League of Cities but that a ban on all severance taxes would be unconstitutional under that decision).

69. 441 U.S. 141 (1979).

70. Id. at 150.

71. See text at notes 39-42 supra.

72. Tennessee v. Louisville and Nashville R.R., ___ F.2d___ (6th Cir., 79-1515, March 20, 1981), aff'g, 478 F.Supp. 199 (M.D. Tenn. 1979), petition for cert. filed 6/18/81 (No. 80-2021); Arizona v. Atchison, T. & S.F. R.R., ___ F.2d___ (9th Cir., 79-3183, June 12, 1981); cf. Louisville and Nashville R.R. v. Louisiana Tax Commission, 498 F.Supp. 418, 421 (M.D. La. 1980).

73. See W. Hellerstein, supra note 16, at 252-53; Browde and DuMars, supra note 68; cf. Parnell, Constitutional Considerations of Federal Control over the Sovereign Taxing Authority of the States, 28 Cath. U. L. Rev. 227 (1979).

74. See note 68 supra.

75. Commonwealth Edison Co. v. Montana, ___U.S.___ (Slip. op., p. 17).

76. Id. at n.18.

77. Id.

78. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 199 (1824).

79. See Hodel v. Indiana, 49 U.S.L.W. 4667, 4671 (U.S., June 15, 1981).

80. See McLure, The Interstate Exporting of State and Local Taxes: Estimates for 1962, 20 Nat. Tax J. 49 (1967).

Senator DURENBERGER. Our next witness is Professor Lewis Kaden, Columbia Law School. He has written extensively on fiscal disparities and severance taxes. We appreciate your being here this morning and we thank you for your contribution. Your printed statement will be made a part of the record. You understand what our time limitations are.

TESTIMONY OF LEWIS B. KADEN, COLUMBIA LAW SCHOOL

Mr. KADEN. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before the subcommittee this morning on this important subject.

Let me say at the outset, as my statement indicates, I did participate in the *Montana* case. I represented a group of approximately 50 Members of the House and the Senate who filed an amicus brief in support of the plaintiffs' position.

As we all know, the Court's decision leaves this probem in the lap of the Congress. Notwithstanding the position I took in that brief on behalf of my clients, I think that is an appropriate place for the responsibility for dealing with this problem. Historically, it is the task of the most representative branch of Government—that branch most responsive to the electorate—to deal with major controversies involving the allocation of authority between the National Government and the States.

The problem, which you have begun to consider this morning, presents as serious a threat to the Federal system and poses as complex a set of issues affecting the allocation of responsibility and power in this Nation between and among the States as any that will come before the Congress in this decade.

The statistics are, of course, familiar and I need not repeat them. There is taking place in this country a massive wealth shift, comparable—as you indicated—to the wealth shifts taking place in the world between the producing nations and those industrialized countries dependent on energy from the OPEC nations. In this country, the energy wealth gap, or that part of the wealth shift caused by energy taxes and energy revenues, supplements a host of other factors with which we are familiar—climate, lifestyle preferences, labor costs, regulatory burdens, lower tax rates in other areas, Federal spending policies, and defense procurement policies. All of these have the effect of shifting investment from the older industralized regions of the country, principally in the Northeast and Midwest, to the newer developing sections of the country in the South and Southwest.

The energy wealth gap, though, adds onto these other factors in dramatic terms. One needs only to look to the most dramatic example, the State of Alaska. The Alaska Department of Revenue estimates that in 1988 or 1989, oil production alone will produce $10 billion for the State government. This is a State with 400,000 persons. They estimate approximately $25,000 of revenue receipts from energy for each person in the State. I suspect a good many more persons will move to Alaska in light of those statistics. Most of those funds, as you indicated, will be paid by taxpayers outside of Alaska.

That is only one example of the kind of wealth shift that is taking place. I suggest that the peril to the Federal system which the Congress needs to address is not simply the fact that a number of States are running out of money and other States are amassing large funds, but the political and social consequences of the wealth shift are very dramatic and serious. I mentioned three of those consequences.

First is the fiscal tilt itself. In the industrialized section of the country 10 or 12 States are literally on the brink of bankruptcy. The New York fiscal crisis is not over, and even more serious is the fiscal plight of States like Michigan, Ohio, and Pennsylvania. The kind of fiscal tilt caused by energy revenues, and those other factors I mentioned, is not good for the state of the Nation. That is true not simply because it contributes to fiscal crises in certain States and substantial surpluses in others, but it creates an imbalance which is inimical to the integrity of the Nation.

Second, it produces an inclination toward retaliatory taxes. The urge to export a State tax burden is increasingly apparent in several States. Last year, Connecticut and New York attempted to enact an oil gross receipts tax and to insure that it not be passed onto their own residents. The Federal courts struck down the pass-along prohibition in both statutes. Just last week, the NewYork State Legislature passed another set of taxes. In that set of nuisance taxes, raising approximately $800 million to rescue the transit system, one can see evidence once again of an effort to shift as much of the tax burden as possible onto out-of-State residents. That kind of rivalry in the Federal system is not a healthy political development.

Third, it distorts the political process as well. Some time ago, I was counsel to the Governor of New Jersey when New Jersey first adopted an income tax. Many members of the State legislature honestly believed that their political futures were at stake as they contemplated that issue and the courts were putting pressure on them to change the tax structure. In some cases, they were right. Some members of the State legislature did lose their race for reelection, in part, perhaps, as a result of that vote on the tax. But those constraints make the political process work in State taxing decisions.

There were no constraints, as Secretary Rogers said, on the Montana Legislature's decision raising the severance tax to 30 percent. The nature of the coal market and the coal supply contracts were such that they did not have to think about the political consequences on their own constituents by that tax vote. The same is true when Alaska determines its severance tax rate on oil, or when Texas determines the rate of its oil severance tax. That kind of distortion in the political process is not good, either.

It is easy to describe the problem. As you said, the task before the Congress is not so easy. Let me introduce the question of legislative alternatives by dividing them into two categories. There are a number of what I would call "narrow gage" changes in the law that the Congress might consider and, indeed, has considered in the past which would be a help toward redressing this imbalance of which I have spoken.

The fact that producing States are rewarded in the General Revenue Sharing formula for their general tax effort makes no sense to me.

That is not the kind of tax effort for which the General Revenue Sharing formula was meant to reward States in the allocation of funds.

The fact that severance taxes are deducted in the calculation of the windfall profits tax on oil—notwithstanding the efforts you, Mr. Chairman, made with Senator Danforth and others to redress that inequity when the windfall profits tax was first enacted—further widens the tilt in fiscal wealth. The same is true as a result of the failure to include State energy royalties under the windfall profits tax.

These kinds of what I call "narrow gage" issues ought to be addressed. They have been controversial in the past and they will, no doubt, be controversial in the future. They point up, I think, an important political fact of life: The potential for stalemate in this area is great. It is incumbent on the Members of Congress to see this as a threat to the national system, to the Federal system as a whole, and not as a contest for wealth among the individual States.

There are "broader gage" reforms that are possible. Your proposal to impose a percentage limit on severance taxes is one. I must say that I would prefer, at the outset, to try something more comprehensive. The percentage limit requires a calculation of the appropriate percentage that, no doubt, will vary from one fuel to the other. It will not be the same for oil as it is for coal. The circumstances of each producing State are not necessarily similar. It also fails to address the problem of royalty revenues. I think one has to look at the energy revenues being reaped by the producing States in the aggregate, and not simply looking at taxes, royalties, impact funds or reclamation funds as different, disunited revenue sources.

I suppose that leads me to prefer a more ambitious approach. I am not suggesting that the political task will be easy or even that the design of an appropriate statute is a simple matter. However, a more comprehensive approach which looks at this problem of energy revenues across the country and tries to determine a fair allocation would better address the widening gap. I would start out by acknowledging that the producing States do incur impact costs and should be generously rewarded under any formula. However, "generously rewarded" does not mean $25,000 a person in the State of Alaska, or an unlimited capacity to tax coal mining in Montana.

I would like to see some kind of Federal levy. The technical device could be in the form of a credit for State taxes on the imposition of a limitation on the rate of State taxes. It could be formed as a broad proscription of State taxes, with an energy revenue sharing formula sending the money back on a basis that rewarded the producing States but also adjusted the fiscal tilt in the Nation.

I would like to see, too, the energy revenues, raised through a national severance tax on energy production, used to fund a new Reconstruction Finance Corporation (RFC). A National Bank for Reconstruction—of the kind suggested by Felix Rohatyn and others introduced by Senator Moynihan in the last Congress—would be authorized to rebuild infrastructure in industrialized areas of the Nation, rescue those industrial companies which deserve help because their products are important to the national interest, and aid the development of new technologies that will make this Nation's economy more competitive in world markets.

I participated in the drafting of a bill to create the RFC last year. At that time we proposed a corporate income tax surcharge to support it. It seems to me now, as part of an effort to address this problem of energy revenues, that the best way to help the consuming regions of the country is not by giving them a few more dollars in revenue sharing or more grants-in-aid, but by creating an institution which can act in partnership with the States to rebuild their infrastructure and promote economic investment of the type that will enhance the Nation's competitiveness in world markets and its capacity to develop new products.

Thank you.

Senator **Durenberger**. Thank you very much for your statement. When I put my budget restraint hat on, I am not sure the idea of another national bank is the answer to the problem.

Let me ask you about the national severance tax concept which you suggested. In the Finance Committee back in 1979 and 1980, we were dealing with something very similar to that. It was called the windfall profits tax. After we levied the tax, the President's budgeters, and everyone else in the world, took the tax and used it for a whole variety of purposes which were totally unrelated to what we were trying to accomplish.

That is one of the problems with this concept unless we can get into a trust fund or something else. Another problem, however, is the reaction we are going to get—or we do get—if we propose a national severance tax of some kind on those States with the energy resources. That is the heritage argument. We have heard that Montana has 25 percent of the Nation's coal and 50 percent of the low-sulfur coal. Seventy-five percent of that is on Federal land. I don't want to drag the Alaska lands argument into this, but people in Montana feel as strongly as we do in Minnesota about the resources within our borders.

How do you answer that State heritage argument?

Mr. **Kaden**. I suggest that basing the determination on purported State ownership is about the same as the consuming States basing their position on their fiscal problems. Both are true. The coal was there in Montana when Montana was settled; however, the fact is that this is a union of several States and we are, for better or worse, in the same economic condition. Our problems are national in scope. It does Montana or Alaska no good if they become as rich as Kuwait while Pennsylvania, Michigan, or Ohio are winding their way through the bankruptcy court.

I suppose that is what I mean about the responsibility falling on Members of Congress, regardless of their own ties to their home States, to look at the issue of fiscal disparities as a national problem, potentially a national emergency, and to work out a fair solution. That is why I say part of the solution has to be a very generous reward to those States which do have these mineral deposits. The question is where to draw the line, and how to keep that reward from becoming so great that it tilts the Federal system.

Senator **Durenberger**. Let's deal with another possible solution. When I first met the Governor of Montana a few months ago, we had one thing in common—the Milwaukee Railroad. The one thing we did not have in common was my legislation on severance taxes.

I invited myself up to Montana and he said, "You better come disguised." I went anyway 2 weeks ago. One of the things we talked about was the impact of a national energy policy on exactly what the States are doing—or the nonpolicy, as the case may be at the current time. Both of us came to the same conclusion. If our Nation's energy policy is going to be premised on what I characterized as a national self-sufficiency policy, then you can't really blame the Governor—or anybody else in the State of Montana—for saying: "We are going to get some piece of the action, because the action isn't going to be here for very long." Particularly since the State has already been ripped off by other mining interests in its history.

What do you suggest would be an appropriate national energy policy regarding this while there are State severance taxes?

Mr. Kaden. I think that the policy has to take into account the fact that these resources are depletable and the environmental, social, and economic costs imposed on a State like Montana are considerable. I have no problem, at all, with a system of State revenues—whether it comes from severance taxes or from royalties—being divided between current expenditures and a trust fund to account for the fact that the resource will not be there indefinitely. It is a question of the appropriate level, and it is a question of whether or not the political constraints are operating to keep those local decisions in bounds.

I think the evidence is that they are not operating now. That is why legislation, such as yours, is needed. If you work the formula out properly, you are still giving Montana the benefit of its coal, the same as Arizona the benefit of its sunshine. I think with good will that a fair allocation can be achieved. It is not an easy analytical problem. Obviously, it is not an easy political problem. But the consequences of not doing it, I think, make it necessary to undertake the effort.

Senator Durenberger. The coal-producing States, in effect, could provide this country with a sensible national energy policy. If you could get Montana, North Dakota, Wyoming, and others together, they could cartelize their operations and get the right kinds of environmental legislation so we would still need them. Then Jim Sasser and some of the other Members could use their taxing systems to impact on supply. There is a way, in effect, they could all do us a favor by creating a national energy policy with regard to the source of energy. That is possible, isn't it?

Mr. Kaden. I think that is right. To some extent that is happening, too, because of changes in the industrial structure of the energy business. The movement of the oil industry into coal production means, in effect, an integration of those two sources of energy in terms of corporate responsibility for decisions.

Among the Federal Government and its officials responsible for energy, the Congress, the executive branch, the States that have an interest in these supplies, and the industry groups, you have some of the major participants in the design of energy policy, including levels of production and levels of pricing. That is not a cartel, but it is something like the American equivalent of the decisionmaking process on energy policy.

Senator DURENBERGER. Thank you very much for your testimony. I have many more questions I could ask you now, but, as I indicated earlier, this is an ongoing process, so I will leave them for another time. We appreciate your contributions today and look forward to working with you in the future.

[The prepared statement of Mr. Kaden follows:]

STATEMENT OF LEWIS B. KADEN
PROFESSOR OF LAW, COLUMBIA UNIVERSITY LAW SCHOOL

HEARINGS ON FISCAL DISPARITIES IN THE FEDERAL SYSTEM BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS OF THE UNITED STATES SENATE, JULY 15, 1981

I appreciate the opportunity to appear today and participate in the Committee's consideration of state energy revenues and their effects on the federal system. The subject matter of these hearings is of critical importance to the nation. With the Supreme Court's decision on July 2, 1981 in the case of Commonwealth Edison Co. v. State of Montana (No. 80-581), Decided July 2, 1981) rejecting the constitutional claim that Montana's coal severance tax interfered with interstate commerce, it is plainly the responsibility of the Congress and the Executive Branch of government to assess the consequences of state taxes and royalties derived from energy development, and to determine whether there exists a need for federal legislation imposing some limitation on the mineral producing states' capacity to raise revenues from mining activity.

In Commonwealth Edison, both Justice Marshall, writing for the Court, and Justice White, concurring, invited congressional consideration of these issues. The Court concluded that "the appropriate level of state taxes must be resolved through the political process."(slip. op. at 17). Marshall wrote that "under our federal system, the determination is to be made by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests. (p. 17). Justice White was more explicit. "Congress has the power" he wrote, "to protect interstate commerce from intolerable or even undesirable burdens . . . . The constitutional authority and the machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress . . ."(slip. op. at 1-2).

The Court has, therefore, remitted to Congress the issues raised by state efforts, to borrow Justice White's phrase, "to aggrandize their position and perhaps lessen the tax burdens on their own citizens by imposing unusually high taxes on mineral extraction." Before attempting to make some comments on those issues, let me briefly describe my own background as it pertains to this area. I am currently a Professor of Law at Columbia Law School and Director of the Center for Law and Economic Studies at Columbia University. From 1974 to 1976, I served as Counsel to the Governor of New Jersey and during the period 1977 to 1979, while on the Columbia faculty, I was an Advisory Board member and, later, counsel to the Coalition of Northeast Governors. I also filed a brief amici curae in the Commonwealth Edison case in the Supreme Court on behalf of a group of United States Senators and Representatives, who supported the appellants' position that the Montana tax violated the Commerce Clause of the United States Constitution.

I suggest that the increasing tendency of energy rich states to exploit their natural resources through rising levels of severance taxes, poses a serious threat to our federal system. The peril lies not simply in the potential of those states with great reserves of oil, gas or coal to amass significant amounts of revenue. Rather, the interests of federalism are potentially jeopardized in three related ways: (1) the fiscal tilt or distortion in the nation's political economy caused by exported tax burdens, effected when a state is able to shift the obligation to pay for its public services substantially over to the residents and taxpayers of other states; (2) the injury to the political process that occurs when the lawmakers in energy rich states are able to raise revenue without the political constraints that commonly affect deliberations on tax bills, again because the burden of paying the tax is placed on out-of-state consumers of local energy; (3) the likelihood that other states will retaliate by attempting to export part of the cost of their government services to out-of-state taxpayers, thereby increasing sectional conflict and further distorting the political process.

Obviously, my summary of the perils to federalism from exported tax burdens assumes an important economic fact, and may, by so doing, masque a complex analytic problem. I submit that these threats to federalism follow if tax burdens are substantially shifted out-of-state. In fact, a calculation of the ultimate incidence of energy taxes requires an evaluation of demand elasticity for the product, alternate sources of supply, substitutable sources, contracts for the energy source and other factors.

Still, at least at first blush, the statistics and the record to date concerning the potential for fiscal tilt in the federal system as a result of energy revenues, are alarming. Eight energy rich states control the nation's reserves of oil, gas and low sulfur coal. These states are raising enormous revenues from mining activity, in part through increased rates of severance taxes, and in part through the application of old percentage rates to the dramatically higher prices caused by oil and gas price decontrol. As a result of oil price decontrol alone, eight major oil producing states will reap increased revenues amounting to $116 billion during the 1980's. Total receipts from oil and gas development in the major states is estimated to exceed $220 billion in this decade, without any increase in state tax rates. The Alaska state government projects severance taxes and royalties from oil development of more than $10 billion a year by the late 1980's. Total decontrol of natural gas prices would add another $60-90 billion in severance tax and royalty revenues to the states of Texas, Louisiana, Oklahoma and New Mexico.

Two states -- Montana and Wyoming -- produce 68% of low sulfur coal, the type favored by natural environmental policies to promote clean air. More than 90% of this coal is exported. By the year 1987, consumers in the states of Minnesota, Iowa, Illinois, Indiana, Wisconsin, Michigan, Ohio and New York alone will pay about $240 million in coal severance taxes annually to Montana and Wyoming.

What is happening as a result of price decontrol for oil and gas, increased dependence on western coal, OPEC pricing on the world market, and state taxing decisions, is simply a massive wealth shift out of the consuming regions of the country and into the eight or nine major producing states. This energy wealth shift has a cumulative effect, since it adds to the force of factors such as climate, labor costs, regulatory burdens and life-style preferences, as well as national policies on procurement and grants-in-aid, all contributing to the declining economies of the older, industrialized regions of the country.

The potential exists for a serious polarization of the nation, with the states dividing into hostile camps. The consequences of sectional conflict on a nation are already apparent in Canada. Here at home, the states rich in mineral resources foresee lower tax burdens, substantial surpluses in public budgets, improved services and widening economic prosperity. By contrast, other states which depend on energy from these producing states face growing deficits, deteriorating public services and economic decline.

Of course, the effects of the wealth shift will not all be felt at once. Per capita income is still high in some Northeastern states. But it is striking to note the gap in circumstance in different states. Alaska, Montana, and Texas anticipate growing surpluses, notwithstanding significant tax reductions. Alaska has essentially eliminated non-energy sources of state revenue, and Montana has enacted reductions in property, income and excise taxes. By contrast, the Northeast-Midwest states from Massachusetts to Illinois face exceedingly dim fiscal prospects. When revenue is drastically needed, as it is, for example, to rescue New York City's ailing transit system, the only available recourse is substantially to increase fares and taxes, looking for whatever opportunity exists to push the tax burden onto someone outside the state's borders. But for states without energy resources, the quest for exported taxes is more difficult. Both Connecticut and New York failed last year in attempts to enact gross receipts levies on the oil industry which precluded the taxpayer from passing along the burden to in-state consumers. Just this month, the New York legislature adopted a package of new taxes to support transit, including a new formula for calculating corporate income taxes and a new form of the oil gross receipts tax, without any pass-along prohibition. At least one major oil company, has already responded by increasing its local prices by 3¢ a gallon.

The problem should be obvious. A nation such as ours must function economically as a union. When policies and economic activity coincide to pit one section against another, the nation becomes polarized and the union suffers. The national interest is the ultimate loser in a widening contest for wealth between groups of "winners" and "losers" among the states and regions.

Throughout our history, it has fallen to the Congress to assert the national interest against sectional claims. Today, the energy wealth gap presents another in that series of challenges and opportunities. The task is not easy. The potential for stalemate is great, and the inclination to take the parochial view will be strong.

Nor is the best form of national legislation evident as the debate and deliberations begin. Yet, although the challenge of designing an acceptable bill will be great, the broad goals of energy tax legislation may be simply stated. First, it should restore and maintain fiscal balance in the federal system. Second, the producing states should at least realize sufficient revenues to meet the costs, broadly defined, that are imposed on government by mining activities, including reasonable sums to account for the fact that the energy source is depleting. Third, the national policy should serve the objectives of energy independence, reducing our reliance on imported oil. Fourth, to the extent feasible, the energy wealth of the nation should help support the kind of public infrastructure, such as transit facilities, which are critical to energy independence and economic wellbeing in the country.

It is critical in this debate to avoid shibboleths and slogans which are dramatic, but not illuminating. The debate is not enhanced by claims by the producing states of sovereign ownership of mineral resources or by changes from the consuming states of an American OPEC exacting tribute from the rest of the country.

If the goals may be easily stated, the most appropriate means of achieving them is more difficult to identify. To date, most proposals focus on percentage limits, or caps, on the rate of state severance taxes. Currently, oil is taxed by the major producing states at rates from 12.5% to 1.5%, gas over a range from 10% to zero, and coal at rates from 30% to zero. Also, the proportion of exported oil varies from 64% in Texas to more than 85% in Alaska. More than 90% of the coal from Montana and Wyoming is exported. In addition, the producing states share in leasing royalties received by the United States from mining on federally owned lands, and an additional 40% of the federal revenue from mineral leases is returned to the states for reclamation. A comprehensive assessment of the economic consequences of mineral development must take account not just of severance tax rates but of all state revenues attributable to energy development. For example, in the year 1989, the state of Alaska anticipates oil severance taxes of approximately $4.2 billion, royalties of $6.0 billion, property and income taxes from oil companies of $2.4 billion, compared to only $464 million for all other, non-petroleum revenue sources.

Congress could, alternatively, or in addition to a percentage limit on state severance taxes, raise royalty arrangements to ensure a more equitable distribution of these proceeds from exploitation of federal lands. Careful analysis is required to determine the optional level of economic rent and the best allocation of the rents derived from mineral production.

On a more comprehensive basis, Congress might consider replacing state severance taxes and royalties with a national levy on energy extracted from the mines, with the revenues shared nationally on the basis of a formula designed to serve the goals of fiscal balance, payment for impact costs, energy independence and rehabilitation of public infrastructure in the consuming regions. The funds could be distributed through a revenue sharing formula or through a public development corporation charged with investing in energy or other innovative technologies, industrial revitalization and public infrastructure. Such a corporation--a new Reconstruction Finance Corporation, funded by energy taxes and fees--could assist in improving productivity and increasing the competitiveness of U.S. products in the world economy. The corporation, combined with a grant-in-aid or revenue sharing program to offset mining impact costs in the producing states.

More modest initiatives might be considered as well. These include revising federal grant formula so that producing states are not rewarded for their severance "tax effort;" subjecting state royalties to the windfall profits tax, a proposal defeated when the WPT was first enacted; revising the tax laws to eliminate deductions for state severance taxes for purposes of federal corporate income or windfall profits tax.

Each of these proposals, and variations of them, require careful analysis and consideration. I believe the time is right for creation by Congress of a new Reconstruction Finance Corporation. Funded by fees or taxes on mineral development, such a corporation could serve the important goals of promoting energy independence, enhancing American competitiveness in world markets, and rebuilding the public infrastructure critical to the life of our major urban areas. At the same time, appropriate limits on state taxes and royalties from energy sources can restore fiscal balance in the federal system, curb the distortions in the economy caused by rising energy prices, and still assure continued prosperity to those states which enjoy reserves of energy deposits.

The basic dilemma of federalism in the 1980's--the "new question" of the distribution of authority between the federal government and the states, in Woodrow Wilson's phrase--is how to deal with the balkanizing effects of shifting public wealth. The hearings which begin today before this Committee should initiate a serious debate in the national government and among the states of that dilemma and the best means to resolve it.

Senator **Durenberger.** Our next witness will be Senator John Melcher. We are moving him up on our agenda with apologies to our other witnesses. John, we welcome you here and look forward very much to your testimony on the issue of severance taxes and how they relate to fiscal disparities between the States.

TESTIMONY OF HON. JOHN MELCHER, U.S. SENATOR FROM THE STATE OF MONTANA

Senator **Melcher.** Thank you very much, Dave. My apologies to the other witnesses. I will try to be very brief.

There have been some Midwestern and Southern utility companies misrepresenting the facts about Montana's coal severance tax. They should be really compared to Pinocchio. When Pinocchio told untruths, his nose grew longer.

In attempting to nose out rising electrical costs for their consumers, there has been a concerted effort on the part of these utility companies, using Western coal to generate electricity, to con their consumers into believing that coal severance taxes are the cause of their higher and higher electrical bills. That is not true. It would be a just reward if, in making those misstatements, their noses would grow longer and longer—like Pinocchio's—so the public would know.

I will show in my testimony that Montana's coal tax, which netted the State $70 million last year, amounted to a true cost of 2 percent or less to electrical consumers' bills for these utility companies burning Montana coal to generate electricity. For the average consumer of those companies, that was $5 of their total annual bill. That was a small cost—a very fractional cost—of the total cost of the Montana coal. The cost was mostly represented by the freight charges to haul the coal to the utility plants and, indeed, these freight charges are rising.

At a time when rising energy costs plague all consumers, I welcome, and the Montanans welcome, a real examination of what costs what in providing energy needs for the Nation. A long Pinocchio's nose to snoop out these facts is OK, but untruths or misrepresentations serve no good purpose.

The facts justify Montana's coal severance tax as not only being in the interests of the people of Montana, where we pay the same tax for Montana's coal as do the consumers in other States, but also demonstrate that the Montana tax is in the best interest of the consumers in other States where Montana coal is burned.

In the interest of all consumers knowing the facts, today's hearing has a broad scope involving the development of our Nation's energy resources.

As coal production increases, Montana's coal tax raises the revenue used locally to meet some of the costs of government services needed by the people living and working in the coal fields.

Montana—and I suspect this is true of all other energy and mineral producing States—has accepted the responsibility to help the rest of the country use the natural resources located, by chance of geology, within our borders.

Montana has also accepted the responsibility to insure that the people who come to work in the new or expanding coal mines or who already live nearby have water, sewer, roads, health care, schools, and other necessities. Our State has further accepted the responsibility to help future generations of taxpayers pay the costs that inevitably accompany the bust end of the boom-and-bust cycle common to energy and mineral development in the West.

One of the very important problems of strip mining in the arid West, which shouldn't be minimized here, is that no one can guarantee today exactly what impacts will or will not occur in these prairie lands as a result of strip mining coal seams 20- to 50-feet thick.

I doubt that we will hear a challenge to the fact that all responsibilities must be met and that it costs dollars. If we are all in agreement with the basic point that no State should become a colony to be exploited and plundered by other sections of the Nation, a question central to this hearing today is: Who should pay those costs?

The Montana Legislature decided that the most efficient and fair way to pay those costs would be to tax the coal actually removed from the earth and consumed. This would also be the fairest way for the people who benefit from the ultimate use of the coal removed to share in the costs.

As the U.S. Supreme Court recently found, Montana's tax not only does not unduly interfere with interstate commerce, but it also does not discriminate against anyone, because it is levied against coal destined for use both within the State and outside the State, in equal measure. This tax is also the cheapest way of meeting those costs. After-the-fact repairs of damages done in uncontrolled resource developments elsewhere in the Nation has obviously been at a greater cost than if careful mitigation along the way would have been required.

That contention leads us to the greatest misconception of all; namely, just how great a cost the Montana coal severance tax is to all those consumers of the electricity produced from the coal. Testimony last year in the Senate Energy and Natural Resources Committee on a bill to limit State coal severance taxes to a maximum of 12½ percent showed that Montana's coal tax revenues are a drop in the bucket compared to total severance taxes in the Nation. Total State collections in 1979 from severance taxes amounted to some $2.9 billion. Montana's share of those collections was 1.8 percent. Our coal severance tax collected $42 million.

Despite Pinocchio misstatements by some hired hands of some utility companies—hired hands being public relations people—that Montana's coal severance tax was a burden, more than one witness testified last year that our tax added less than $10 to the annual utility bill of an electricity consumer in the Midwest. The research provided to me showed the impact to be less than $5 a year per household. That works out to be less than 2 percent of those customers' annual electricity bills. I find it ironic that this 2 percent is somehow defined as a burden, when some of the home States of those electricity users have imposed State sales taxes on the same electricity ranging from 2 to 5 percent.

The most recent contract prices for coal in Montana, as it is loaded on railcars, ranges from $5.38 to $11.51 per ton. The tax on that tonnage ranges from $1.61 to $3.45 per ton. Last year's figures submitted to the Energy Committee on transportation charges for that coal ranged from $8 to more than $23 per ton.

The very low impact of the Montana tax on the ultimate consumer, plus the willingness of their own States to tax the same electricity at a higher rate, plus freight rates exceeding the value of the coal itself, taken together, all laid to rest the notion that reducing coal severance taxes is a consumer issue. I am far more interested to see what the hearings today and tomorrow produce as being the real issues at hand.

The U.S. Supreme Court has settled the question that Montana's coal severance tax is constitutional. The Supreme Court has settled the question of whether our tax discriminates against interstate commerce. It does not discriminate.

The concurring Justices in our case agreed that the rate of taxation to be applied is not a judicial matter, but a decision to be made by the legislative branches of government—specifically and primarily the State legislatures. Specifically, the Court held that:

> * * * [this] determination is to be made by State legislatures in the first instance and, if necessary, by Congress, when particular State taxes are thought to be contrary to Federal interests.

Even the dissenting Justices agreed that there is no identifiable Federal interest in the statutes that could support a supremacy clause challenge against our tax.

Although the Court did not get into how much of the consumers' bills are for electricity, I want Congress and the public to know what our coal severance tax costs them. It would mean saving Midwestern electricity consumers less than 2 percent of their annual utility bills—if, indeed, their bills were to even go down following the outlawing of Montana's tax.

There is a real question of what structure would be in place if the coal severance tax, for some reason, was completely removed from Montana. What structure then would set the utility bills in Wisconsin, Illinois, and some of the other States? Would they really reduce it and thereby save the consumers 2 percent? Utility companies will, indeed, continue to pay freight and other charges, and those charges are going to go up. Those are the higher costs; utility spokespersons should give the facts.

In addition, some States charge their consumers a sales tax of 2 percent or more on their electric bills: for example, Iowa, 3 percent; Illinois, 2 percent; Michigan, 4 percent; Minnesota, 3 percent; and Wisconsin, 4 percent. I must add, Wisconsin applies its tax only half the year, in the spring and summer months.

Congress needs to assist in developing a sound energy policy. Using more coal is part of developing that sound policy. Montana, with more coal than any other State, is gradually building up production. As mines expand or new ones open, the coal severance tax helps make it work.

I think the people throughout the country stand to gain a lot of knowledge about how their energy is produced from this subcommittee's work. If more people learn that their lamps light at the flip of a switch only at a cost to the land and people of Montana, I am confident that knowledge will be a benefit. The public, as a result of these hearings, can learn that Montana's efforts to bring about orderly coal development are sound, and that our coal severance tax helps that development. If that happens, then, like Pinocchio, we will have a happy ending.

Congress will be better able to confront the greater issues of State and Federal cooperation in meeting the needs ahead of us. There is an interrelationship of tax bases at all levels. Montana's coal severance tax is reasonable and helpful in developing Montana's coalfields. Pinocchio, in the end, told the truth, and that made the happy ending possible. I hope that happens in this case, too.

Senator DURENBERGER. Thank you very much.

Let me start by explaining why this bill is being heard in the Subcomittee on Intergovernmental Relations. We are trying to put it in the perspective of the relations between the 50 States, and not necessarily in a perspective of trying to decide whether 30 percent is fair or unfair. Yet, we cannot avoid dealing with the kinds of issues which you and other witnesses have raised.

Let me see if I understand your testimony correctly. In effect, there is a claim that this is a burden on consumers in Minnesota, Wisconsin, et cetera, and therefore a burden on interstate commerce. At best there is something like a 2-percent burden—as you called it—on Minnesota or other electricity users. Compared to transportation costs, this is minuscule.

What would your opinion be if, instead of being 2 percent, it were 4 percent, 6 percent, or 8 percent? At what point do you think it becomes a burden on consumers in other States?

Senator MELCHER. I wouldn't know. It certainly isn't anywhere near there now. If it were a burden, these other States would immediately force their legislature to take off their sales taxes as it affects their electric bills. I think what is important is to let the marketplace decide. Let your utility company decide whether they want the burden of Montana coal. Some of them have decided that they have some pretty cheap coal contracts.

As a result of that, we had to have some money to meet some of the local costs. I don't think anybody is going to argue that $70 million is a big amount of money in a State like Montana to meet some coalfield expansion costs. Are we going to produce more on our tax? Sure, because we will probably expand the field if the market decides they want more Montana coal.

So I don't have any set knowledge of whether 2 percent, 3 percent, or 4 percent would be too much to pay for meeting those head-on costs.

Senator DURENBERGER. But one of your solutions was as long as there is a sales tax of some kind—and you alluded to the 3 percent in Minnesota—there is some indication that in Minnesota the 2 percent can't be high enough to be a problem or else they would get rid of the sales tax. As a practical matter, Minnesota has a sales tax because Minnesota is broke. Minnesota cut its spending this year by $1 billion and still came up $503 million short.

Minnesotans are paying Montana taxes to get energy. It costs them not because of Montana, but because of the mixed-up energy policy in this country. It costs them two and three times as much as it did a few years ago.

Senator **Melcher**. It would cost them even more if they didn't have that coal. It is pretty cheap going into Minnesota. It is pretty cheap Montana coal. If they use somebody else's coal, they will have a higher bill.

We pay for steel when we buy cars, or what have you. Part of that cost is taconite taxes. I don't think your taconite tax is too high. I am sitting here telling you—I hope convincingly—that our coal severance tax isn't too high.

Senator **Durenberger**. On the taconite we are talking about 4 percent on a $400-per-ton ore. It works out to a minuscule amount of money.

Senator **Melcher**. We are talking about $5 coal, $10 per ton. Then you had your $10 Burlington Northern freight charges, which is $20.

We are 22 percent. So we are pretty low.

Senator **Durenberger**. Let me ask about the other side of your argument. You talked about there not being an impact on consumers, but you have made the argument on the other side. You said the crux of this whole matter is "Who should pay the costs," and you elaborated on a lot of costs.

Would you go through for us the amount of severance tax which is related to the cost of the government in Montana with some specificity? Also would you elaborate for us what Montana does with royalty income? What it does with the money that comes back from the reclamation fund? What it does with a whole variety of other financial mechanisms set up to relieve the burden of extracting and processing coal in Montana?

Senator **Melcher**. I am a good person to do that because my home is in Rosebud County, which has more of the mines than any other county. We have had, in our county, more of the impact as these mines have been reopened, expanded or new mines brought into action.

What we do with the money is award it. I will give you some examples. Most of the money has gone to schools: $2.4 million went to the Forsyth Elementary School, $2 million to the Hardin Elementary School, and $1.5 million to the Miles City Community College. In addition, we put $657,000, two-thirds of $1 million, into the Colstrip Water Treatment Plant; almost $1 million into the Hardin sewer installation; $204,000 for Forsyth solid waste treatment; and $3.7 million for Colstrip High School.

We have rebuilt 22 miles, are in the process of completing 22 miles of the road between Colstrip and Forsyth. It is two-thirds complete and there has been no Federal match. We had to get the money somewhere. It is an unsafe highway, and the traffic is too heavy. We have lost more people on that strip of highway than was ever killed on any road out of Rosebud County.

So far the trust fund still has $75 million in it and it is going to increase. The awards are given out rather judiciously and slowly to needs where people can demonstrate there is real impact. I have only given you a few examples. I am here to tell you that the Coal Board, which administers the fund, is rather cautious on how they pay out. They want to be sure the effect is there and they can get the most mileage out of the buck.

As to other revenues that are raised, in 1980, we got $8 million from the Federal Government under the Mineral Leasing Act, which is also used in the general fund of Montana. It may not go specifically to these various fields. The revenue raised out of the Mineral Leasing Act is used broadly. Congress gave it direction when we raised the amount of revenue that would be allocated to the States.

Combined, we are not talking about a great deal of money. Thank goodness our State is still solvent, not like your State. Only a few years ago—my father and a lot of my relatives live in Minnesota so I follow, as you well know, what happens there—when Governor Quie came over, it was thought Minnesota's treasury was in great shape. The Governor said he wasn't going to raise taxes or anything. Then, all of a sudden, all that has changed.

That can change very rapidly for Montana, too. As we expand these coalfields, we are trying to keep ahead. We are trying to make sure that the money used by this method is used wisely so we can possibly expand these fields without doing a lot of damage to the workers and the other people who live in the area.

Senator **DURENBERGER**. I was reading the Supreme Court opinion. Just because it is in the Supreme Court opinion doesn't necessarily make these accurate statistics. So I will ask you, "Does the severance tax on coal and other minerals in Montana now raise about 20 percent of the State's total revenue?"

Senator **MELCHER**. No; something less than that.

Senator **DURENBERGER**. Nineteen and a half?

Senator **MELCHER**. It is close to 19, but we are talking about a great variety of taxes.[1]

Senator **DURENBERGER**. Since 1980, has 50 percent—

Senator **MELCHER**. Let me just make something clear: 34 percent of the State of Montana is Federal land. Naturally, we are going to have to have some revenue raised out of that. The 19 percent includes all of that, too.

Senator **DURENBERGER**. Starting in 1980, has 50 percent of the severance tax been going into this heritage fund, or whatever it is called——

Senator **MELCHER**. Trust fund.

Senator **DURENBERGER**. Is that correct?

Senator **MELCHER**. Yes; that is correct.

Senator **DURENBERGER**. In 1979, did Montana pass legislation providing property and income tax relief for State revenue?

Senator **MELCHER**. Did Montana?

Senator **DURENBERGER**. Yes.

Senator **MELCHER**. I would assume they did. I would hope they did. We have had some rather high tax bases. There is only one county involved in this coalfield development that has been able to reduce their mill levy. That was certainly because Colstrip No. 1, No. 2, No. 3, and No. 4 started to go on the tax base.

I suppose we will go through that period in Rosebud County, too. After you have a big addition—such as the type that huge powerplants can make—to a tax base of a small county, you will get some reduction.

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[1] Revenue last year from Montana's coal severance tax was 18.6 percent of total tax collections. Of the total revenue to the State, the coal tax provided about 5½ percent.

Source: Office of Budget and Program Planning, Montana Governor's office.

Senator DURENBERGER. My last question deals with, "Why 30 percent?" It has been suggested that one of the reasons some States impose a high severance tax is to discourage production. In my visit to Montana, I didn't detect a rationale for 30-percent severance tax on coal. Yet some of the witnesses here this morning will indicate that the amount of severance tax may be responsible for the fact that the growth in production in Montana has been less than was anticipated. It is currently up to 30 million tons a year. In Wyoming, which has substantially less severance tax, the growth has quadrupled to 100 million tons. For what purpose was the 30 percent set as a figure in the severance tax?

Senator MELCHER. There is no magic in 30 percent. The legislature decided that the offsets which go against this and other local taxes came out to about 30 percent. They tied it to the amount of Btu so it would vary as to the value of the coal. They applied it at a fair point; that is, as the coal is loaded on the railcar. They applied it to everybody in the State and out of the State.

They thought they were going to need a certain amount of money to meet the impact. So far they are proven correct. We collected $70 million last year out of a production of something around 30 million tons of coal. They knew that would provide some funds to be doled out to schools, roads, and so on. So far, they have been correct on it. Like any tax, if they find that it is not correct or proper, they can change it. So far they believe it is about right.

I don't think there is any magic in the 30 percent at all. It is the questions "Can you meet the needs at the proper time," and "Is it too big a burden on consumers." Our consumers have said "No." They know what it costs them in their utility bills. We are saying 2 percent of anybody's utility bills to meet these costs should not be too high. We don't think it is.

Senator DURENBERGER. John, thank you very much for your testimony. As I indicated before you arrived, this is an ongoing process and an ongoing set of hearings. We trust that the views articulated by you and by others will be in greater detail in future months.

Senator MELCHER. I want to thank you very much, Mr. Chairman. I would like to ask that the statements by my colleagues, Senator Max Baucus and Senator Malcolm Wallop be made a part of the record.

Senator DURENBERGER. Without objection, their statements will be made a part of the record.

Senator MELCHER. Thank you very much.

[The prepared statements of Senators Baucus and Wallop (with attachment) follow:]

STATEMENT OF SENATOR MAX BAUCUS

I appreciate the opportunity to submit testimony today, although, frankly, I believe that continuing this effort to challenge the Montana coal severance tax is unprecedented, unfair and unreasonable. It will divide the U.S. Senate unnecessarily and will accomplish virtually nothing beneficial. The assault on state taxation authority has gone on long enough.

Earlier this month, those utilities and coal companies which challenged the Montana coal tax were dealt a mortal blow. The U.S. Supreme Court held that there are no legitimate constitutional objections to Montana's tax. It does not violate the Commerce Clause, the Supremacy Clause, or the 14th Amendment.

It does not discriminate against out-of-state consumers. It does not conflict with national energy policy statutes. It is not unreasonably related to the advantages obtained by coal companies, utilities and consumers who have access to Montana coal. In short, the tax was given a constitutional clean bill of health.

In past years, we have made it clear—time and time again—that the tax amounts to only a few cents per day in a typical consumer's bill. In fact, if Montana coal were not used, consumers' utility bills would increase significantly. Montana coal—tax and all—is a bargain for Midwest consumers.

Montana coal is found in thick, level seams near the surface. As a result, the initial extraction costs are lower than other sources of coal such as coal from the East. And Montana coal is dramatically less expensive than oil on a BTU equivalent basis.

Millions of dollars are saved by use of Montana coal. That is a fact that no coal tax opponent has admitted to his constituents. Your constituents do in fact save money by using Montana coal. It is unfortunate that the press generated on this and other hearings has not reflected that fact. And your hearing will be a disservice if the point is not conceded.

In addition, I have not seen a single piece of evidence that the utilities would reduce their bills one cent if the Montana tax were abolished. Nor is it clear that the coal companies would open any more mines than they already have. The evidence is strong that the tax has not hampered reasonable coal development in the state and it will not.

As Montanans have made clear, we will contribute to resolving this national energy predicament. We will permit and encourage responsible coal development consistent with our state's strong and forward looking reclamation laws.

We won't rip off our fellow consumers in the Northwest, Midwest and South because we know we share a common economic destiny. We buy commodities made from Minnesota resources—and we do not complain about the money paid even though we know a considerable portion of Minnesota's iron ore tax is used for tax relief.

The reason we don't complain is that we know all states export their tax burdens to some extent. And even if all of the Montana tax was passed forward to consumers—which it clearly is not—Montana would still rank evenly with other states in exporting taxes.

Beyond that, Montana history demanded that severance tax approach to resource extraction. Coal development is a one-time harvest. Once the resource is gone, only the costs of development remain. In the past, Montana has ridden this rollercoaster of boom and bust to its prejudice. The result, over and over again, has impoverished families, disintegrated neighborhoods, busted towns.

The human toll of these misadventures is not easy to quantify. You can't manipulate a hand calculator to add up the damage. But my fellow citizens know those costs and they know the severance tax is legitimate.

We could have hidden the tax—and still could if a cap is passed. We all know that. But the State of Montana was forthright and direct in adopting its tax to help pay the costs of coal development and, equally important, to help provide a framework for stable, diverse economic development when the coal boom is ended.

Mr. Chairman, examining the distribution of federal dollars is a worthy undertaking. But you should not use that theme as a way to attack Montana's tax. Our tax is fair. It is reasonable. It does not harm the residents of your state or any other. It does, however, help insure that some unfortunate aspects of Montana's past will not be mirrored in our future.

I urge you to back away from this unnecessary regional warfare. Attacking the Montana severance tax may make good headlines. But it is not good policy and it is not a solution to the nation's energy woes.

STATEMENT OF SENATOR MALCOLM WALLOP

Mr. Chairman, I appreciate this opportunity to present my views on state severance taxes generally and coal severance taxes in particular. It is my understanding that this hearing has been held in response to the recent decision of the U.S. Supreme Court in Commonwealth Edison, et al. v. Montana, et al.

Clearly, the hallmark of the well-reasoned decision is the resolution of the issue of whether or not State severance taxes on resources which will or may be exported are subject to judicial scrutiny under the Commerce Clause of the Constitution. That right of judicial scrutiny has been established and consists of a four-part test previously conceived of by the Supreme Court in the 1977 decision of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279.

The validity of Montana's coal severance tax turned on the last two Complete Auto Transit tests, which require that the tax not discriminate against interstate commerce and that the tax is fairly related to the services provided by the State. In reviewing the tax under the discrimination test, the Court aptly observed that the Commerce Clause does not give:

> residents of one State a right of access at "reasonable" prices to resources located in another State that is richly endowed with such resources, without regard to

> whether and on what terms residents of the resource-rich State have access to the resources. We are not convinced that the Commerce Clause, of its own force, gives the residents of one State the right to control in this fashion the terms of resource development and depletion in a sister State... (Slip op. at 8).

Under the "fairly related to the services" test, the Court's conclusions were based on well established tax law, illustrated by the following passage from the decision:

> ...there can be no question that Montana may constitutionally raise general revenue by imposing a severance tax on coal mined in the State. The entire value of the coal, before transportation, originates in the State, and mining of the coal depletes the resource base and wealth of the State, thereby diminishing a future source of taxes and economic activity. (footnote omitted) Cf. Maryland v. Louisiana, --- U.S. --- (slip op., at 32). ... When, as here, a general revenue tax does not discriminate against interstate commerce and is apportioned to activities occurring within the State, the State "is free to pursue its own fiscal policies unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society. (Slip op., at 13) (Citations omitted).

In the final analysis, the Court determined that the appropriate level or rate of taxation that the taxpayer should contribute is a legislative and not a judicial matter,"to be made by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests". (Slip op., at 17) (footnote omitted).

The concerns of the Court should be of equal concern to this Congressional body. It would be very bad politics and law to grant the residents of one State, or one part of the country, the right to control the terms and conditions of resource development and depletion in their sister States through federally imposed limitations on their ability to collect general revenue taxes. Moreover, when a State's revenue tax is reviewable by the judiciary under the Commerce Clause and survives such scrutiny, Congress should allow the state to pursue its own fiscal policies "unembarrassed by the Constitution." By definition, it could not possibly be in the Federal interest to usurp a State's legislating authority under these circumstances.

This brings us to the present criticism of and the proposed Federal limitation (Senate Bill 178) on Montana and Wyoming coal severance taxes. This issue is a blatent political red herring. Because of their up-front percentage tax formula, the people of Montana and Wyoming have been separated out for special abuse as blue-eyed Arabs. The fact is that this up-front percentage has little to do with the amount of tax collected by the State or the impact on the consumer. In that vein, I requested that the Congressional Research Service compare Wyoming's severance tax with those of the other major coal producing States. The conclusions of that report speak for themselves, and I request that it be printed in full at the end of my statement.

To further illustrate my point, I quote from the May 5, 1981 update of the Congressional Research Service issue brief entitled Energy:

Limiting State Coal Severance Taxes (pages 5-7):

The major attack on Montana's and Wyoming's severance taxes has been the assertion that the high rate places and undue burden on utility consumers in other States -- consumers who have no voice in deciding on the severance tax rate. To look at this burden, and to provide some comparision between the impact of coal severance taxes and oil and gas severance taxes, a methodology was employed that compares the severance tax on a unit of end product to the cost of that end product to the consumer using current 1980 data and assuming a total pass-through of the tax. For purposes of comparison, the highest severance tax rate for each of the three major resources was used: 12.5% for oil (Louisiana), 10% for natural gas (Alaska), and 30% (adjusted for credits allowed by Montana) for coal (Montana). Also, the following conversion efficiencies were assumed: 94% for oil, 97% for natural gas, and 30% for electric powerplants. Except for electricity, end product costs reflect current national averages as do raw product costs. Electricity prices were estimated from current regional figures for cities predominately relying on oil, coal, or natural gas. The results are as follows:

END-USE PERCENTAGES: MARCH 1980

End product	Price at point of taxation	Amount of severance tax	End-use cost	Percentage end-use cost as tax
Oil-fired powerplant (electric)	$17.00/bbl.	$2.125/bbl	$.07/kw	6.3%
Home-heating oil	$17.00/bbl	$2.125/bbl	$.86/gal	6.3%
Gasoline	$17.00/bbl	$2.125/bbl	$1.20/gal	4.1%
Residential Gas	$1.30/mcf	$0.13/mcf	$3.50/mcf	3.8%
Coal-fired power plant (electricity)	$12.00/ton (MT-9300btu/lb)	$2.64/ton	$.045/kw	3.6%
Gas-fired (electricity)	$1.30/mcf	$0.13/mcf	$.045/kw	3.4%

END-USE PERCENTAGES: MARCH 1981

End product	Price at point of taxation	Amount of severance tax	End-use cost	Percentage of end-use cost as tax
Oil-fired powerplant (electric)	$38.00/bbl	$4.75/bbl	$.84/kw	11.8%
Home-heating oil	$38.00/bbl	$4.75/bbl	$1.30/gal	12.0%
Gasoline	$38.00/bbl	$4.75/bbl	$1.35/gal	8.1%
Residential Gas	$1.60/mcf	$0.16/mcf	$4.10/mcf	4.0%
Coal-fired powerplant (electricity)	$12.00/ton (F.O.B. MT; 9300btu.lb	$2.64/ton	$.046/kw	3.5%
Gas-fired (electricity)	$1.60/mcf	$0.16/mcf	$.058/kw	3.2%

While these numbers should be considered "ballpark" in nature, they show that Montana's severance tax rate imposes about the same or less of a burden on other States than the examined severance tax rates on oil or gas from the perspective of the end product that the consumer actually uses. The reason for this is two-fold. First, coal in general, and western coal in particular, is cheaper per btu than oil or gas. In September 1980, the national average delivered cost of coal permillion btu was $1.39. This compares with $4.11 for residual fuel oil and $1.94 for natural gas for the same million btus. Second, while some products of crude oil and natural gas are used in a fairly direct manner (gasoline, home-heating oil, residential gas), coal is almost exclusively used in powerplants to generate electricity. Because of this coal becomes a small input cost into the price of the final product as opposed to some oil and natural gas products, and therefore the impact of the severance tax is less. This is not to say that Montana's tax is reasonable, only that it doesn't place more of a burden on consumers than other severance taxes on oil and natural gas.

Commonwealth Edison, et al. v. Montana, et al. stands as a rule of reason controlling State severance taxation authority. I hope that this Subcommittee and this Congress realize that Congressional limitation on this form of State taxation would open up Pandora's box and set precedent that would haunt and adversely effect every state in this Nation.

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Washington, D.C. 20540

February 12, 1981

TO : Honorable Malcolm Wallop
Attention: Ann Vance

FROM : Larry B. Parker
Analyst
Environment and Natural Resources Policy Division

SUBJECT : State Severance Taxes (and equivalents) on Coal

In response to your request for a comparison of state coal severance taxes, I have developed a table comparing the severance taxes (or equivalent) of major coal producing states on a per ton basis. Also, I have footnoted other significant taxes on coal and recent changes in tax rates.

For the purposes of comparison, the table includes gross production taxes [West Virginia (3.85%), Montana (30%), Kentucky (4.5%), and Wyoming (10.5%)], and severance taxes [North Dakota ($.65 per ton, 1978), Colorado ($.60 per ton, 1978) and New Mexico ($.40 per ton, 1978)] collected by the state for distribution. Other significant taxes, such as local taxes, are footnoted. The difference between a gross production tax and a severance tax is that a gross production tax is levied on a measure of the dollar value of the product extracted from the mine, and a severance tax is levied at a set amount per unit amount produced. This distinction has been muddled by the Bureau of the Census which as defined a severance tax as follows:

> Severance Taxes - Taxes imposed distinctively on removal of natural products--e.g., oil, gas, other minerals, timber, fish, etc.- from land or water and measured by value or quantity of products removed or sold.

Such a definition allows Wyoming's State tax on coal to be considered a severance tax while West Virginia's Business and Occupation tax on coal is not.

To put the gross production taxes on a per ton basis, I have divided the tax collection (or assessment in the case of Wyoming) by the tons of coal produced for the year 1978. Severance taxes have been included as is. The results are as following:

COMPARISON OF STATE COAL SEVERANCE TAXES (OR EQUIVALENT) FOR MAJOR PRODUCERS ON A PER TON BASIS

STATE	1978 Coal Production 1/ (thousands of tons)	Severance tax (or equivalent) on production 2/ (thousands of dollars)	Tax per ton for 1978
West Virginia	100, 869 3/	130,298 4/	1.29
Montana	26, 600	33,624 5/	1.26
Kentucky	135, 689	127,765 6/	.94
Wyoming	58, 328	42,935 7/	.74
North Dakota	TAX LEVIED ON A PER TON BASIS		.65 8/
Colorado	TAX LEVIED ON A PER TON BASIS		.60 9/
New Mexico	TAX LEVIED ON A PER TON BASIS		.40 10/

1/ Source: Form EIA-7, Department of Energy

2/ Source: U.S. Bureau of the Census. State Government Tax Collections in 1979.

3/ Production is for fiscal year 1978-1979

4/ Source: West Virginia Business Tax Department. Figure is for fiscal 1978-1979 and includes state and local receipts from the coal production tax.

5/ Does not include local gross proceeds tax (approximately 4.5% of value) and resource indemnity trust tax (.5% of value).

6/ Does not include Kentucky's property tax on the value of unmined coal.

7/ Source: Wyoming Department of Revenue and Taxation. Number is assessed taxes, not collections. Does not include local ad valorem tax of approximately 6.5% of value. Tax assessment on 1978 production from local tax is $26,552,000. If included in above calculations, Wyoming's per ton tax is $1.19.

8/ Tax increased in 1979 to $.85 per ton and $.01 per ton for every 4-point increase in the wholesale price index. July 1980 value: $.93 per ton.

9/ Tax was changed in 1979 to $.60 per ton (surfaced mined), $.30 per ton (deep mined), plus 1% for each 3-point increase in the wholesale price index. Sepember 1980 value: $.738 per ton (surface mined). Does not include property tax on the value of unmined coal,

10/ Effective July 1, 1977. Tax is $.38 per ton on steam coal and $.18 per ton on metallurgical coal. A surtax amounting to the percentage increase in the consumer price index attaches effective Juy 1, 1978 et. sub. Assuming CPI increase of 6% from 1976 to 1977, the July 1, 1978 rate would be $.40 per ton (.38 x 1.06 = .4028). July 1980 value: $.57 per ton. Does not include resource excise tax at .75% of value and conservation tax of .18% of value. July 1980 value: $.158 per ton. Total production tax (1980): $.728 per ton.

There are two primary reasons why Wyoming's coal taxes (even if the local assessment is included) are not out of line with the eastern states of West Virginia or Kentucky. One is that Wyoming allows deductions for some federal royality payments. For 1978, this deduction reduced taxable coal production in Wyoming by about two million tons. As more federal lands are opened up in Wyoming, this deduction will increase. Secondly, the cost of Wyoming coal is considerably less than that of eastern coal. As the enclosed table indicates, the F.O.B. price of Wyoming coal is less than a third of the F.O.B. price of West Virginia coal (NOTE: F.O.B. price is not the price used for tax purposes. The average 1978 price of Wyoming coal for tax purposes was about $7.00 a ton).

If you need more information, feel free to call me at 287-7238.

PRODUCTION AND VALUE OF BITUMINOUS COAL AND LIGNITE IN 1978 (FINAL)

State	Production (Thous. Short Tons) Underground	Surface	Total 1/	Value ($ per Ton FOB) Underground	Surface	Total
Alabama	6,169	14,383	20,553	39.22	27.94	31.33
Alaska	-	731	731	-	W	W
Arizona	-	9,054	9,054	-	W	W
Arkansas	3	516	519	W	W	39.86
Colorado	4,511	9,303	13,814	26.20	12.70	17.11
Georgia	-	113	113	-	52.23	52.23
Illinois	24,841	23,760	48,600	21.60	19.27	20.46
Indiana	552	23,630	24,182	18.72	18.17	18.18
Iowa	108	342	450	W	W	16.10
Kansas	-	1,226	1,226	-	20.28	20.28
Kentucky						
East	41,624	54,608	96,233	28.86	22.58	25.30
West	17,860	21,596	39,456	22.78	18.35	20.36
Total	59,484	76,204	135,689	27.03	21.38	23.86
Maryland	382	2,616	2,998	24.16	18.70	19.40
Missouri	-	5,665	5,665	-	17.89	17.89
Montana	-	26,600	26,600	-	7.37	7.37
New Mexico	576	12,056	12,632	W	W	10.08
North Dakota	-	14,028	14,028	-	5.17	5.17
Ohio	11,897	29,340	41,237	31.50	17.82	21.77
Oklahoma	2	6,068	6,070	44.40 e/	21.41	21.42
Pennsylvania	32,925	48,551	81,477	37.75	21.15	27.86
Tennessee	4,150	5,882	10,032	23.30	23.14	23.21
Texas	-	20,020	20,020	-	6.04	6.04
Utah	9,141	-	9,141	21.52	-	21.52
Virginia	21,511	10,435	31,946	33.05	25.24	30.50
Washington	-	4,708	4,708	-	12.07	12.07
W. Virginia	65,216	20,099	85,314	35.45	25.70	33.15
Wyoming	708	57,620	58,328	20.88	8.97	9.11
TOTAL 1/	242,177	422,950	665,127	$30.94	$16.53	$21.78

W Withheld to avoid disclosing individual company data
1/ Data may not add to totals shown due to independent rounding
e/ Estimated
SOURCE: Form EIA-7, Department of Energy.

Senator DURENBERGER. We are now getting to the point where we are impacting on people's schedules.

The next witness will be former Representative Andrew Maguire. Congressman, thank you very much for wanting to participate in the process today. We have your full statement which will be made a part of the record.

TESTIMONY OF ANDREW MAGUIRE, OF MITCHELL-FEIN, INC.

Mr. MAGUIRE. Thank you very much, Mr. Chairman. I am delighted to have this opportunity to participate in these hearings.

For years, the States have been reaching out to exact taxes from activities which cross their State lines. By and large, their claims on these revenues have been sustained by the Supreme Court, as indeed was the case recently with the Montana tax, which has already been discussed here today. The Court did not decide, by the way, that the up-to-30-percent rate represented good public policy as, at least, some members of the Court implied. That is a job for the Congress.

Indeed, from time to time, Congress must reexamine the premises which underlie these taxes, must reevaluate the Federal formulas affected by them, and must assess and reassess the impact which these Federal formulas have on relative fiscal positions of the States. These hearings are particularly important, Mr. Chairman, because we have reached such a time when a reexamination should take place.

Some may regard the discussion as academic, but actually billions are at stake. The staff of the Advisory Commission on Intergovernmental Relations (ACIR) estimates that imperfections in the existing per capita income approach for the distribution of Government funds overestimate the fiscal needs of some of our wealthiest States by as much as 40 percent. In contrast, it is the assets of States, like those in the Northeast and Midwest region, that are typically overstated, in this case by as much as 20 percent. As Congress embarks on an ambitious budget cutting process, seeking to trim $141 billion in Federal expenditures over the next few years, these imbalances must be watched. Otherwise, the cuts will indeed exacerbate the kinds of disparities about which this subcommittee is concerned.

We know where these disparities can be found: Alaska, its treasury swollen with oil and gas revenues, has retired its income tax. Nonagricultural employment in mineral-rich producing States like Montana and New Mexico has grown 2½ and 4 times faster, respectively, than the job growth rate in my State of New Jersey, for example.

At the same time that New Jersey receives 69 cents in Federal services for each dollar its citizens pay in taxes, Montana receives $1.18 for each dollar sent and New Mexico receives a staggering $1.91.

As Arthur Laffer said 1 year ago before the Joint Economic Committee, "The circumstances may not be optimal for the country as a whole." For Alaska, of course, the circumstances are exceptionally good.

Beyond the regional issues, the question of fiscal disparities involves equity and economic efficiency considerations which apply nationwide. The fiscal advantage accruing to certain States—particularly those with oil, gas and mineral revenues—is so large that the geographic allocation of economic resources is being severely distorted. I note the excellent comments made by Lewis Kaden earlier on that point.

I would like to focus my remarks more narrowly on two areas where Federal policy has resulted in imbalances. First, the impact of State severance taxes on the General Revenue Sharing formula and on the windfall profits tax. I will address my comments involving General Revenue Sharing to the testimony of Deputy Assistant Treasury Secretary Rafuse before this subcommittee on May 13.

As you will recall, Mr. Rafuse asserts in his testimony that:

> Despite the surge in severance tax revenues, most of the shift in the revenue sharing allocation—from 1980 to 1985—is attributable to factors other than the energy crisis.

He estimates that the shift due to severance taxes amounts to just $21 million. Other factors, he argues—such as changes in income, population and employment—are primarily responsible for the redistribution. But there are several flaws in this argument, and I think we should look at them.

First, and very important, Mr. Rafuse's analysis stops with 1985, and really with 1983 projected figures, which will be the ones used for the 1985 General Revenue Sharing distributions. In other words, he stops just as the major impact of decontrol will become effective with respect to State revenues, including the severance tax. The Northeast-Midwest Institute, by contrast, has looked at the period from 1980 to 1990. It estimates that somewhere in the neighborhood of $100 million will be added to severance taxes during that period.

Mr. Rafuse's analysis covers less than one-tenth of that real impact because the number he develops, for the period to 1983, is only $9.4 billion. It is that figure which he breaks down then into two components, one which is the $6.1 billion add-on, which he attributes to the energy crisis. Clearly, all of his arguments are undermined and flawed by that particular shortcoming of the timeframe in his analysis.

Second, he assumes that there is no link between the demographic trends, which I have cited and of which this subcommittee is fully aware, and what he calls the energy crisis. He simply ignores, therefore, the fact that money and lower taxes play a major role in encouraging the relocation of a region's assets.

There remains a third and fundamental flaw in Mr. Rafuse's arguments. That is, the numbers he used were derived from what has become a faulty formula. The tax effort component was intended by the Congress to represent the relative tax burden borne by residents of a community. It no longer does so.

As Mr. Rafuse points out, States are displacing some of their additional severance tax revenues by reducing taxes in other areas. This is one technique they use to compete for regional assets. By doing so, a State has effectively lowered its tax burden; local taxes have been replaced by exported ones. The tax effort formula as it stands, however, would not reflect this. In fact, the apparent tax effort would increase. Thus, instead of reducing revenue sharing payments to the most affluent States, Federal policy assists those States most capable of assisting themselves and ignores the rest. Were the tax effort to be measured more accurately, Mr. Rafuse would find that the shifts in resources due to the energy crisis—in a full understanding of its nature—were substantially larger than he suspects. In fact, the General Revenue Sharing payments going to energy-rich States would almost certainly decrease.

Two methods of minimizing this distortion come to mind. They involve, respectively, adjusting the numerator or the denominator of the tax effort formula to account for these issues. The first is the approach which I took last year during the reauthorization of the revenue sharing program—that is, to exclude from the calculation of total tax collections that portion of taxes determined to be exported.

An alternative way to redress the problem is to replace State personal income with a factor that better approximates fiscal capacity. The problem with the current measure is that most communities have income sources that are unrelated to the incomes of their residents.

As John Shannon, Assistant Director of ACIR, stated in your May 13 hearing:

> The per capita income measure now used in Federal aid formulas understates the revenue generating capacity of the mineral-rich States, and overstates the tax capacity of States with relatively high personal income but relatively small property, sales or mineral tax bases.

The most effective way to restore meaning to the tax effort formula of GRS—and to other Federal formulas which currently use the per capita income measure—would be for Congress to adopt the "Representative Tax System" approach recommended by the ACIR. The reason is that personal income really can't measure accurately now what it needs to measure, given the continued rise in energy prices and associated tax yield and the demographic shifts to the West. The Representative Tax System is better equipped to reflect these changes.

While the GRS program is highly visible, there are carefully disguised subsidies. The Windfall Profits Tax Act, which could be a case study of exemptions and exclusions, is a good place to look for these "invisible subsidies." The intent of the windfall profits tax was to capture, for the residents of the 50 States, the economic rents resulting from monopoly pricing of oil that decontrol took away from them as consumers. Congress rejected the notion that these windfall gains should be allowed to accrue to the small number of Americans fortunate enough to enjoy oil company holdings. Yet, despite the strong efforts of Senators Durenberger and Danforth, the final legislation heavily tilted the benefits of the trillion-dollar decontrol toward the producing States without nearly adequate compensation for the consumers in the "energy have-not" States.

One such loophole permits the deduction of State severance taxes from the windfall tax. This is essentially a hidden form of revenue sharing. Before the oil is taxed, before the Federal Government can raise the revenue, before the moneys are disbursed throughout the Nation, the oil-producing States can siphon off their oversized rewards from decontrol.

Because of this deduction, every time that a State decides to raise its severance tax rate, money which would otherwise flow to the National Treasury is being diverted to the coffers of that State. Since the legislation was enacted, 11 States increased or established severance taxes on oil and gas. With this incentive to claim additional Federal resources, the regional disparities will only be exacerbated. This additional source of revenue for the already swollen treasuries of energy-rich States must be halted, if equity is to be a consideration.

I will take just another minute to conclude, Mr. Chairman. The easiest way to guard against further transfers of this kind is to enact an amendment limiting the severance tax deduction to the level of the tax imposed on March 31, 1979. The windfall profits tax bill which passed the House included this freeze on the severance tax deduction. As we look for revenues on the national level to shrink the deficit, and as we recognize that the current effective tax rate of the windfall profits tax is 30 percent, this deduction should be eliminated. Certainly, there is going to be some fiscal disparity but there isn't any point in having it be greater than it needs to be.

Federal formulas must be revised, as much of the testimony here suggests. We need to propose amendments to the Tax Code also, with respect to natural gas and with respect to other aspects of fiscal disparities between States.

Mr. Chairman, I will be happy to answer any questions. In the interest of time, I will not complete the balance of my statement.

Senator **Durenberger**. I think your critique of Mr. Rafuse's testimony on May 13 is really important. I will try to clarify one or two of the things you said. I understood your estimate of the Treasury. Not that it inaccurately represents the pros of the revenue sharing fund under the present formula, but the study does not point out the fact it is a faulty General Revenue Sharing formula which fails to reflect some of the changes going on in the real world.

The most important flaw, of course, is that as economic development increases per capita income in energy-rich States, it serves to offset any effective formula that would be introduced by increased tax effort and would decrease the General Revenue payment.

I understand you to say that what should occur in this formula—if it was adequate to reflect actual decreases in real tax burden which the severance tax makes possible—is that energy-rich States should experience a proportionate decrease in their share of the revenue sharing pot.

Is that correct?

Mr. **Maguire**. That is correct and very clearly stated, Senator. I would add that, aside from the actual effect, which you have just summarized, we should not forget that Mr. Rafuse's analysis is also flawed as a result of the fact he deals only with the period up to 1983. This begs the question in advance because it doesn't deal with the enormous shifts of resources and the very, very high expected rates of severance taxation which will occur from 1983 to 1990.

I wish to say at this point that I commend you for the legislation which you have introduced. I think it is exactly the right way to go with respect to a Federal assertion of responsibility.

Senator **Durenberger**. Let me briefly deal with the windfall profits tax. One of the things I learned from that experience was that you can spend a lot of time—and I think we spent 13 weeks in the Senate Finance Committee—constructing a piece of legislation, but it is in conference where the law is actually made.

We have already talked this morning about what happened to the targeting of the proceeds. You made the excellent point that we should consider carefully the limiting of severance taxes to those that existed at a particular time. Now we are facing another attack on the windfall profits tax. We haven't seen it yet because this administration has told those who would attack the tax to leave it out of this tax bill. Somewhere out there it is coming. There is a bill right now—S. 700, sponsored by Malcolm Wallop—that is just a little piece of this. I would like to insert in the hearing record, at this point, Senator Wallop's introductory statement for S. 700 and the text of the bill.

[The statement and the text of S. 700 follows:]

[From the Congressional Record, Mar. 12, 1981]

EXEMPTION OF STATE SHARE OF FEDERAL ROYALTIES FROM WINDFALL PROFITS TAX

Mr. WALLOP. Mr. President, today I am introducing legislation to redress the inadvertent financial burdens imposed on States, local governments, and Indian tribes by the windfall profits tax. I cannot believe the windfall profits tax was ever intended to handicap the financing of projects for the public good. States, local governments, and Indian tribes do not reap "windfall profits," they do not transgress the public interest by hoarding money and misallocating resources. On the contrary, they benefit the public interest by providing necessary services. Nevertheless, the windfall profits tax limits the ability of these governments to provide basic services. This legislation remedies the situation by exempting Federal royalty oil from the tax, by making local ad valorem taxes and tribal severance taxes deductible from the tax, and by clarifying a term used in assessing tax liability.

As is generally known, the windfall profits tax (WPT) directly affects the amount of domestic petroleum exploration and development by siphoning off cash flow that otherwise would be used to finance such ventures. Not widely known, however, is that the WPT indirectly affects the amount of exploration and development by eroding the quality and limiting the quantity of logistical support provided through the governments of mineral producing regions. Oil wells do not drill themselves; oil does not flow from reservoir to refinery in some mysterious process that requires little or no help.

Hundreds of workers are needed to drill each well and hundreds more are needed to develop it for commercial production. As a result, locations proximate to the oil fields face a massive influx of population. Historically, these "boomtowns"—whether they existed previously as communities or just groups of buildings—have been hard pressed to meet the needs of these new workers. The ensuing deterioration of the quality of life in these towns creates many problems, not the least of which are soaring crime and increasing pollution. The attraction of numerous jobs paying high wages in these towns soon pales in comparison to the risks and hardships encountered in living there. Even the high wages become not so high as prices and rents skyrocket to bring equilibrium to demand and supply. Consequently, the influx of people slows and the oil companies are left without the workers they need to explore and develop new petroleum reserves.

To combat this, States and local governments need extra funds. To maintain the livability of their towns, they need more money to provide more public services to more people. Recognizing the costs incurred as a result of mineral extraction, Congress granted the States a share of the Federal royalty on oil in the Mineral Leasing Act of 1920. The Mineral Leasing Act gave the States a 37.5 percent share of the 12.5 percent royalty received by the Federal Government for mineral extraction on public lands. The State's share of the royalty was specifically designated for such public programs as road construction, road maintenance, and funding for local schools. The restriction on the use of the money proved onerous, however.

When an area is newly opened for mineral extraction, local government entities must assume a vast array of public services. The exploding population growth creates demands for more than just new schools and roads. New hospitals, new sewers, more fire and police protection, and other new public facilities are demanded as well. Congress acknowledged this fact and altered royalty oil policy by amending the Federal Land Policy and Management Act of 1976. First, the State's share of the Federal royalty was increased from 37.5 to 50 percent. Second, the 1976 act broadened the allowable use of the State's share of the royalty so that they would have more flexibility in responding to energy development.

The additional 12.5 percent granted to States was not earmarked for specific projects, but was intended for use in such programs as planning community development, expanding public services, and funding new public facilities, with priority going to those areas suffering the greatest impact. As a result of these amendments, the 1976 policy for Federal royalty so that they would have more to help State accommodate energy development than that of 1920.

Unfortunately, passage of the WPT undermined the 1976 policy by taxing the Federal and State share of the mineral royalty, thus reducing the funds returning to the States. Congress has turned its back on its commitment to assist the States in dealing with energy development. In many regions of the West, energy development is deterred by the fact that local governments are unable to provide financing for basic human services. Oil exploration cannot go forth when workers have no schools for their children, have no hospitals for when they are sick, and have no police for their protection.

Adequate services must be provided if we want to attract workers to the energy projects of the Western States. Nonetheless, the States will not be able to provide support for the development of domestic energy resources unless they are able to raise the revenues needed to address energy impact problems. The legislation I am introducing today will help provide adequate funds to the States and facilitate energy development by allowing the full share of the State's royalty from Federal leases to return to the States.

By preventing local ad valorem taxes from being deducted, the WPT deals yet another heavy-handed blow to State and local governments and further distorts their tax treatment. While it allows State severance taxes to be deducted, the WPT reverses this treatment for taxes levied at the local or county level. The nondeductible status of ad valorem taxes generates pressures for these governments to turn them into a severance tax. Any State is free to work with county and local governments to convert ad valorem taxes to a State severance tax, but pursuing this alternative is like opening Pandora's box, with all the attendant consequences.

To change the status of a local ad valorem tax to a State severance tax would require a constitutional amendment in many States. This would inevitably lead to the disintegration of the fiscal relationship between States and their political subdivisions, since revenue formerly going straight to the local level would be routed instead through the State government. Many extra layers of bureaucracy would be needed to rearrange long-established patterns of distributing funds to local governments, and the end result would be that everyone winds up with less money because so much is wasted in the shuffle. The nondeductibility of ad valorem taxes affects not only Government revenue, but also oil company revenue.

Oil companies face the burden of having to pay a double tax on their production—both ad valorem and windfall tax. The additional tax liability can do nothing but discourage the search for and production of domestic oil. My legislation relieves the varied burdens of WPT by making all ad valorem taxes deductible.

The problems created by the WPT for Indian tribes are no less discriminatory than those faced by city and county governments. The WPT puts Indian oil at a competitive disadvantage by allowing oil companies to deduct a State severance tax, but not a tribal severance tax. Companies operating on the reservation of a tribe that imposes a severance tax would have to pay the tribal tax, and then pay a Federal tax on the tax paid to the tribe. The logical alternative for oil companies when confronted with a double tax is to abandon plans for exploration and development on tribal land, which leaves the Indians without a vital source of revenue.

Anyone who is familiar with the economic conditions on most reservations knows that the populations are extremely poor and that there is little business activity to produce revenue. Tribal governments must depend on the royalties and tax revenues from their oil to provide the funds needed to pay for public services. However, the unequal treatment puts pressure on the tribes to give up consideration of severance taxes as a source of revenue, which would further narrow an already meager tax base.

The enactment of taxes on the severing of oil from reservation land is an inherent power of tribal governments—a power recognized by both the courts and the Congress. The Natural Gas and Policy Act acknowledged a tribe's right to tax, and recently the 10th Circuit Court of Appeals in Merrion against Jicarilla Apache Tribe reaffirmed it. Yet, the effect of the WPT is to deny that right and depart from established Federal tax policy. Once again, the WPT impinges on the ability of a government unit to raise funds necessary to meet basic public services. Under this legislation, tribal severance taxes would be made deductible from the WPT and the deleterious effects of this double taxation would be eliminated.

The last problem to be addressed by this legislation is an oversight created by language in the Windfall Profits Tax Act, an oversight that deprives tax-exempt Government entities of money from their net profits interest in oil production. The ambiguity arises from the use of the term "economic interest" in crude oil to describe the governmental interest that qualifies for exemption. The phrase "economic interest," used for depletion purposes by taxpaying oil companies under standard Federal income tax law, has acquired a meaning far broader than the company's net profits interest under an agreement with a nontaxable Government entity. Thus, an oil company with a mere 5 percent, or less, net profits interest may be deemed to have a depletable "economic interest" of 30 percent or more. Reciprocally, the economic interest of the Government agency, despite its 95 percent net profits share, may be 70 percent or less. This increases the WPT paid to the Federal Government by the oil company. The company then deducts the extra tax from gross profits before distributing the net profits share to a tax-exempt public entity, such as a State. The effort is to impose 95 percent or more of the additional tax on the State by directly reducing the amount of money left after expenses which is divided as net profits. This legislation revises the definition of "economic interest" and changes the provision so that tax-exempt entities will receive the full share of their net profits agreements.

Mr. President, the windfall profits tax cannot be allowed to continue to oppress State, local, and tribal governments. The tax treats these bodies as culprits, when in fact, they are victims of its singular purpose to raise revenues for the Federal Government. The Federal Government must stop usurping funds belonging to lower levels of government.

The other government entities have a responsibility to provide basic public services to their people, and their ability to meet public needs should not be curtailed by Federal taxes. Passage of my legislation would alleviate the burdens created by the windfall profits tax on State, local and tribal governments, and in doing so, it would provide those governments with the funds needed to support energy development. I urge my colleagues to support this needed change in the Windfall Profits Tax Act.

97TH CONGRESS
1ST SESSION

S. 700

To amend chapter 45 of the Internal Revenue Code of 1954 with respect to the exemption of the State share of Federal royalties from the crude oil windfall profit tax and to insure the deductibility of certain severance taxes.

IN THE SENATE OF THE UNITED STATES

MARCH 12 (legislative day, FEBRUARY 16), 1981

Mr. WALLOP (for himself, Mr. DOMENICI, Mr. CRANSTON, Mr. SCHMITT, and Mr. HAYAKAWA) introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend chapter 45 of the Internal Revenue Code of 1954 with respect to the exemption of the State share of Federal royalties from the crude oil windfall profit tax and to insure the deductibility of certain severance taxes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. QUALIFIED GOVERNMENTAL INTEREST TO INCLUDE STATE SHARE OF ROYALTIES UNDER THE MINERAL LANDS LEASING ACT.

Subsection (a) of section 4994 of the Internal Revenue Code of 1954 (relating to qualified governmental interest) is amended by adding at the end thereof the following new paragraph:

"(4) Amounts received under mineral lands leasing act.—The right of a State to receive payments under section 35 of the Act entitled 'An Act to promote the mining of coal, phosphate, oil, oil shale, gas, and sodium in the public domain', approved February 25, 1920 (41 Stat. 437, 450; 30 U.S.C. 191), shall be treated as a qualified governmental interest.".

SEC. 2. SEVERANCE TAXES.

(a) Severance Tax Imposed by Indian Tribes.—Subsection (c) of section 4996 of the Internal Revenue Code of 1954 (relating to severance tax adjustment) is amended by adding at the end thereof the following new paragraph:

"(4) Severance tax imposed by indian tribes.—The term 'severance tax' shall include any severance tax imposed by an Indian tribe, and such severance tax shall be treated in the same manner as a severance tax imposed by a State.".

(b) Ad Valorem Taxes.—Subparagraph (B) of section 4996(c)(2) of such Code (relating to definition of severance tax) is amended by inserting immediately before the period a comma and the following: "or on an ad valorem basis determined with respect to the price at which such oil is sold".

SEC. 3. ASSIGNMENT OF COST RECOVERY OIL TO EXEMPT GOVERNMENTAL ENTITIES IN ACCORDANCE WITH THEIR NET PROFITS INTERESTS FOR PURPOSES OF WINDFALL PROFIT TAX.

(a) GENERAL RULE.—

(1) DEFINITION OF PRODUCER.—Paragraph (1) of section 4996(a) of the Internal Revenue Code of 1954 (defining producer) is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

"(B) CERTAIN NET PROFITS INTERESTS HELD BY EXEMPT GOVERNMENTAL ENTITIES.—If under a net profits agreement an exempt governmental entity's cost recovery oil share is less than its net profits share—

"(i) such entity shall be treated as the producer of enough additional cost recovery oil that its cost recovery oil share equals its net profits share, and

"(ii) each party to the agreement having a cost recovery oil share greater than its net profits share shall have the cost recovery oil of which it is deemed to be the producer properly reduced so that the aggregate reduction under this clause equals the increase under clause (i).".

(2) Clerical amendment.—Subparagraph (A) of such paragraph (1) is amended by striking out "subparagraph (B)" and inserting in lieu thereof "subparagraphs (B) and (C)".

(b) Net Profits Interest; Cost Recovery Oil.—Section 4996 of such Code (relating to other definitions and special rules) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) Terms Used in Subsection (a)(1)(B).—For purposes of subsection (a)(1)(B) and this subsection—

"(1) Net profits agreement.—The term 'net profits agreement' means an agreement providing for sharing part or all of the production of crude oil from a property where—

"(A) 1 or more parties to the agreement are to be reimbursed for qualified costs by the allocation of cost recovery oil, and

"(B) 1 or more parties to the agreement are to receive a share of any production of crude oil from the property remaining after reduction for the cost recovery oil referred to in subparagraph (A).

"(2) COST RECOVERY OIL DEFINED.—The term 'cost recovery oil' means crude oil produced from the property which is allocated to a party as reimbursement for qualified costs paid or incurred with respect to the property.

"(3) QUALIFIED COSTS.—The term 'qualified costs' means any amount paid or incurred for exploring for, or developing or producing, 1 or more oil or gas wells on the property.

"(4) EXEMPT GOVERNMENTAL ENTITY.—The term 'exempt governmental entity' means any State or political subdivision thereof and any agency or instrumentality of a State or political subdivision thereof.

"(5) SHARE.—Any party's cost recovery oil share or net profits share is the percentage (or other proportion) which such party has in cost recovery oil or net profits, as the case may be.

"(6) PROPER REDUCTION.—The reductions under clause (ii) of subsection (a)(1)(B) shall be made on the basis of the respective amounts by which each party's cost recovery oil share under the agreement exceeds what such share would be if it were commensurate with such party's net profits share.

"(7) SCOPE OF AGREEMENT.—A net profits agreement shall be treated as covering only shares of production of crude oil held by parties who hold economic interests in the property (determined without regard to subsection (a)(1)(B)).".

(c) Net Income Limitation.—Subsection (b) of section 4988 of such Code (relating to net income limitation on windfall profit) is amended by adding at the end thereof the following new paragraph:

"(6) Cost recovery oil covered by net profits agreement.—For purposes of paragraph (2), if any exempt governmental entity is treated under section 4996(a)(1)(B) as the producer of any portion of the cost recovery oil covered by a net profits agreement (within the meaning of section 4996(h))—

"(A) no other person shall include in his gross income from the property the gross income from such portion, and

"(B) the qualified costs allocable to such portion shall be treated as paid or incurred by such governmental entity (and only by such governmental entity).".

(d) Effective Date.—

(1) In general.—The amendments made by this section shall apply to oil removed after February 29, 1980.

(2) NO INTEREST FOR PAST PERIODS.—No interest shall be paid or credited with respect to the credit or refund of any overpayment of a tax imposed by this title, and no interest shall be assessed or collected with respect to any underpayment of the tax imposed by this title, for any period before the date which is 60 days after the date of the enactment of this Act, to the extent that such overpayment or underpayment is attributable to the amendments made by this section.

SEC. 4. EFFECTIVE DATE.

The amendments made by this Act shall apply to periods after February 29, 1980.

Senator **Durenberger**. This bill would have the effect of exempting Federal oil from the severance tax and making local oil deductible from the severance tax.

Mr. **Maguire**. It is a step in the direction of repealing the windfall profits tax. Already there is the exemption you discussed for the severance tax. Already there is an exemption of State royalties—that is, royalties paid directly to the States. Now, the suggestion in this bill—as I understand it—is that the royalties paid to the Federal Government, that portion which is rebated to the States, will be exempted. In addition the bill, as I understand it, broadens the definition to producers and severance tax for purposes of calculating the reduction, so a new category of cost recovery oil also comes into production.

The bill is designed, as I read it, to provide some additional huge loopholes so that the producing States get additional benefits at the cost of the taxpayers across the country. This is the exact opposite of the principle the windfall profits tax was trying to achieve. It is, in fact, a way of dismantling the windfall profits tax.

Senator **Durenberger**. Thank you very much for your testimony. As I indicated earlier, this examination will continue in the future. We trust you will be willing to come back and share with us your observations on what appropriate public policy should be.

Mr. **Maguire**. I thank you for the opportunity to testify. I commend you for this most important set of hearings. We tried to get the ball rolling in the House of Representatives last year. I am very glad it is rolling in the Senate this year.

Senator **Durenberger**. Thank you.

[The prepared statement of Mr. Maguire, with attachment, follows:]

STATEMENT OF ANDREW MAGUIRE BEFORE THE SENATE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM DELIGHTED TO HAVE THIS OPPORTUNITY TO PARTICIPATE IN YOUR HEARINGS ON "FISCAL DISPARITY, SEVERANCE TAXES AND THE COMMERCE CLAUSE." FOR YEARS, THE STATES HAVE BEEN REACHING OUT TO EXACT TAXES FROM ACTIVITIES WHICH CROSS THEIR STATE LINES. BY AND LARGE, THEIR CLAIMS ON THESE REVENUES HAVE BEEN SUSTAINED BY THE SUPREME COURT. JUST RECENTLY, THE COURT AFFIRMED THE CONSTITUTIONALITY OF THE MONTANA SEVERANCE TAX. THE SUPREME COURT RULED THAT MONTANA'S TAX WAS LEGAL; IT DID NOT DECIDE THAT THE UP TO 30% RATE REPRESENTED GOOD PUBLIC POLICY. THAT IS A JOB FOR CONGRESS.

CONGRESS MUST, FROM TIME TO TIME, REEXAMINE THE PREMISES WHICH UNDERLIE THESE TAXES; MUST REEVALUATE THE FEDERAL FORMULAS WHICH ARE AFFECTED BY THEM; AND MUST REASSESS THE IMPACT WHICH THESE FEDERAL FORMULAS HAVE ON THE RELATIVE FISCAL POSITIONS OF THE STATES. THESE HEARINGS ARE PARTICULARLY IMPORTANT, MR. CHAIRMAN, BECAUSE WE HAVE REACHED SUCH A TIME WHEN A REEXAMINATION SHOULD TAKE PLACE.

SOME MAY REGARD THIS DISCUSSION AS ACADEMIC, BUT ACTUALLY BILLIONS ARE AT STAKE. THE STAFF OF THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS (A.C.I.R.) ESTIMATES THAT IMPERFECTIONS IN THE EXISTING PER CAPITA INCOME APPROACH FOR THE DISTRIBUTION OF GOVERNMENT FUNDS OVERESTIMATES THE FISCAL NEEDS OF SOME OF OUR WEALTHIEST STATES BY AS MUCH AS 40%. IN CONTRAST, IT IS THE ASSETS OF STATES LIKE THOSE IN THE NORTHEAST AND MIDWEST REGION THAT ARE TYPICALLY OVERSTATED--IN THIS CASE BY AS MUCH AS 20%. AS CONGRESS EMBARKS ON AN AMBITIOUS BUDGET CUTTING PROCESS, SEEKING TO TRIM $141 BILLION IN FEDERAL EXPENDITURES OVER THE NEXT THREE YEARS, THESE IMBALANCES MUST BE WATCHED. OTHERWISE, THE CUTS

WILL INDEED EXACERBATE THE KINDS OF DISPARITIES ABOUT WHICH THIS SUBCOMMITTEE IS CONCERNED.

WE KNOW WHERE THESE DISPARITIES CAN BE FOUND: ALASKA, ITS TREASURY SWOLLEN WITH OIL AND GAS REVENUES, HAS RETIRED ITS INCOME TAX. NON-AGRICULTURAL EMPLOYMENT IN MINERAL-RICH PRODUCING STATES LIKE MONTANA AND NEW MEXICO HAS GROWN 2.5 AND 4 TIMES, RESPECTIVELY, FASTER THAN THE JOB GROWTH RATE IN MY STATE, NEW JERSEY. AT THE SAME TIME THAT NEW JERSEY RECEIVES 69¢ IN FEDERAL SERVICES FOR EACH DOLLAR ITS CITIZENS PAY IN TAXES, MONTANA RECEIVES $1.18 FOR EACH DOLLAR SENT AND NEW MEXICO RECEIVES A STAGGERING $1.91. AS ARTHUR LAFFER SAID ONE YEAR AGO BEFORE THE JOINT ECONOMIC COMMITTEE, "THE CIRCUMSTANCES MAY NOT BE OPTIMAL FOR THE COUNTRY AS A WHOLE, BUT FOR ALASKA IT IS EXCEPTIONALLY GOOD."

BEYOND REGIONAL ISSUES, THE QUESTION OF FISCAL DISPARITIES INVOLVE EQUITY AND ECONOMIC EFFICIENCY CONSIDERATIONS WHICH APPLY NATIONWIDE. THE FISCAL ADVANTAGE ACCRUING TO CERTAIN STATES--PARTICULARLY THOSE WITH OIL, GAS AND MINERAL REVENUES--IS SO LARGE THAT THE GEOGRAPHIC ALLOCATION OF ECONOMIC RESOURCES IS BEING SEVERELY DISTORTED. I WOULD LIKE TO FOCUS MY REMARKS ON TWO AREAS WHERE FEDERAL POLICY HAS RESULTED IN IMBALANCES: THE IMPACT OF STATE SEVERANCE TAXES ON THE GENERAL REVENUE SHARING FORMULA AND ON THE WINDFALL PROFIT TAX. I WILL ADDRESS MY COMMENTS INVOLVING GENERAL REVENUE SHARING (GRS) TO THE TESTIMONY OF DEPUTY ASSISTANT TREASURY SECRETARY RAFUSE BEFORE THIS COMMITTEE ON MAY 13.

As you will recall, Mr. Rafuse asserts in his testimony that "despite the surge in severance tax revenues, most of the shift in the revenue sharing allocation (from 1980-1985) is attributable to factors other than the energy crisis." He estimates that the shift due to severance taxes amounts to just $21 million. Other factors, he argues, such as changes in income, population and employment, are primarily responsible for the redistribution. But, there are several flaws in this argument. First, Mr. Rafuses' analysis stops with 1985, just as the major impact of decontrol will become effective with respect to state revenues. Second, he assumes that there is no link between the demographic trends I've cited and the energy crisis. Mr. Rafuse simply ignores the fact that money and lower taxes play a major role in encouraging the relocation of a region's assets.

Leaving these objections aside, there remains one fundamental flaw in his argument; the numbers he has used are derived from a faulty formula. The tax effort component was intended by Congress to represent the relative tax burden borne by residents of a community. It no longer does so. As Mr. Rafuse points out, states are displacing some of their additional severance tax revenues by reducing taxes in other areas--this is one technique they use to compete for regional assets. But by doing so, a state has effectively lowered its tax burden; local taxes have been replaced by exported ones. The tax effort formula as it stands, however, would not reflect this. In fact, the apparent tax effort would increase. Thus, INSTEAD OF REDUCING REVENUE SHARING PAYMENTS TO THE MOST AFFLUENT STATES, FEDERAL POLICY ASSISTS THOSE STATES MOST CAPABLE OF ASSISTING THEMSELVES AND IGNORES THE REST. WERE TAX EFFORT TO BE MEASURED MORE ACCURATELY, MR. RAFUSE WOULD FIND THAT THE SHIFTS IN RESOURCES DUE TO THE ENERGY CRISIS WERE SUBSTANTIALLY LARGER THAN HE SUSPECTS.

TWO METHODS OF MINIMIZING THIS DISTORTION COME TO MIND. THEY INVOLVE, RESPECTIVELY, ADJUSTING THE NUMERATOR OR THE DENOMINATOR OF THE TAX EFFORT FORMULA TO ACCOUNT FOR THESE ISSUES. THE FIRST IS THE APPROACH WHICH I TOOK LAST YEAR DURING THE REAUTHORIZATION OF THE REVENUE SHARING PROGRAM--THAT IS, TO EXCLUDE FROM THE CALCULATION OF TOTAL TAX COLLECTIONS THAT PORTION OF TAXES DETERMINED TO BE EXPORTED.

AN ALTERNATIVE WAY TO REDRESS THE PROBLEM IS TO REPLACE STATE PERSONAL INCOME WITH A FACTOR THAT BETTER APPROXIMATES FISCAL CAPACITY. THE PROBLEM WITH THE CURRENT MEASURE IS THAT MOST COMMUNITIES HAVE INCOME SOURCES THAT ARE UNRELATED TO THE INCOMES OF THEIR RESIDENTS. AS JOHN SHANNON, ASSISTANT DIRECTOR OF A.C.I.R., STATED IN YOUR MAY 13TH HEARINGS:

> THE PER CAPITA INCOME MEASURE NOW USED IN FEDERAL AID FORMULAS UNDERSTATES THE REVENUE GENERATING CAPACITY OF THE MINERAL-RICH STATES, AND OVERSTATES THE TAX CAPACITY OF STATES WITH RELATIVELY HIGH PERSONAL INCOME BUT RELATIVELY SMALL PROPERTY, SALES OR MINERAL TAX BASES.

THE MOST EFFECTIVE WAY TO RESTORE MEANING TO THE TAX EFFORT FORMULA OF GRS--AND TO OTHER FEDERAL FORMULAS WHICH CURRENTLY USE THE PER CAPITA INCOME MEASURE--WOULD BE FOR CONGRESS TO ADOPT THE "REPRESENTATIVE TAX SYSTEM" APPROACH RECOMMENDED BY THE A.C.I.R. STAFF AS THE PROXY FOR FISCAL CAPACITY.

THE PRIMARY ADVANTAGE OF THE REPRESENTATIVE TAX SYSTEM APPROACH TO FISCAL CAPACITY MEASUREMENT IS THAT IS IS ABLE TO DETECT FISCAL DISPARITIES WHICH ARE UNRELATED TO INCOME. THUS, THIS SYSTEM PRODUCES A MORE ACCURATE READING OF THE ABILITIES OF STATES TO RAISE REVENUE. ALL REGIONAL ADVANTAGES--CORPORATE, FARM, AND MINERAL WEALTH--ARE TAKEN INTO ACCOUNT. UNDER CURRENT LAW, WE ARE ASKING A LOT OF A SINGLE, ECONOMIC INDICATOR. PERSONAL INCOME IS BEING USED TO MEASURE THE CONTINUED RISE IN ENERGY PRICES AND ASSOCIATED TAX YIELDS, AND THE DEMOGRAPHIC SHIFTS TO THE WEST. THE REPRESENTATIVE TAX SYSTEM IS BETTER EQUIPPED TO REFLECT THESE CHANGES.

WHILE THE GENERAL REVENUE SHARING PROGRAM IS HIGHLY VISIBLE, THERE ARE ALSO MORE CAREFULLY DISGUISED SUBSIDIES SKEWING THE BALANCE BETWEEN REGIONS. THE WINDFALL PROFIT TAX ACT, WHICH COULD BE A CASE STUDY OF EXEMPTIONS AND EXCLUSIONS, IS A GOOD PLACE TO LOOK FOR THESE "INVISIBLE SUBSIDIES."

THE INTENT OF THE WINDFALL PROFIT TAX WAS TO CAPTURE FOR THE RESIDENTS OF THE FIFTY STATES THE ECONOMIC RENTS RESULTING FROM MONOPOLY PRICING OF OIL THAT DECONTROL TOOK AWAY FROM THEM AS CONSUMERS. AT THAT TIME, CONGRESS REJECTED THE NOTION THAT THESE WINDFALL GAINS SHOULD BE ALLOWED TO ACCRUE TO THE SMALL NUMBER OF AMERICANS FORTUNATE ENOUGH TO ENJOY OIL COMPANY HOLDINGS. AND YET, DESPITE THE STRONG EFFORTS OF SENATORS DURENBERGER AND DANFORTH, THE FINAL LEGISLATION HEAVILY TILTED THE BENEFITS OF THE TRILLION DOLLAR DECONTROL TOWARD THE PRODUCING STATES WITHOUT NEARLY ADEQUATE COMPENSATION FOR THE CONSUMERS IN THE "ENERGY HAVE-NOT" STATES.

One such loophole permits the deduction of state severance taxes from the Windfall tax. This provision is essentially a hidden form of revenue sharing. Before the oil is taxed; before the Federal government can raise the revenue; before the monies are disbursed throughout the nation; the oil-producing states can siphon off their oversized rewards from decontrol. Because of this deduction, every time that a state decides to raise its severance tax rate, money which would otherwise flow to the national treasury is being diverted to the coffers of that state. With this incentive to claim additional Federal resources, the regional disparities will only be exacerbated. This additional source of revenue for the already swollen treasuries of energy-rich states must be halted, if equity is to be a consideration.

The easiest way to guard against further transfers of this kind is to enact an amendment limiting the severance tax deduction to the level of tax imposed on March 31, 1979. The Windfall Profit Tax bill which passed the House included this freeze on the severance tax deduction. As we look for revenues on the national level to shrink the deficit, and as we recognize that the current effective tax rate of the Windfall Profit Tax is 30%, this deduction should be eliminated to capture these otherwise foregone revenues.

Some fiscal disparity is no doubt unavoidable. The scarcity of energy, the pricing power of OPEC, the free market considerations of oil decontrol, and the unbalanced location of American energy resources have combined to bestow unusual wealth on a few energy producing states. But there is no reason why the Federal government should continue to provide perverse rewards and subsidies which further tilt the already alarming imbalances.

Federal formulas must be revised to be fair to all regions and to the country as a whole. Inequities such as that represented by the interaction between the Windfall Profit Tax Act and state severance taxes should be eliminated altogether. Proposed amendments to the Tax Code and the possible deregulation of natural gas must be scrutinized for their impacts on fiscal disparity. Surely, state severance taxes must be prevented from reaching excessive levels. You are to be commended, Mr. Chairman, for your bill, S. 178, which effectively deals with this issue.

As Chief Justice John Marshall once said, the power to tax is the power to destroy. Severance taxes are presently being used to bankroll an economic war between the states. Congress must not allow this devisive battle to take place. Otherwise, in the words of Felix Rohatyn, we will leave "half the country nearly bankrupt, many of its major cities pools of unemployment and unrest and the other half swimming in oil, industry, and wealth. This is not the stuff of a stable democracy; it is not the stuff of a union of states."

Thank you.

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July 15, 1981

MAGUIRE CRITICIZES FEDERAL "REWARDS" FOR ENERGY-RICH STATES

Former New Jersey Congressman Andrew Maguire today warned that federal subsidies to energy-producing states are "bankrolling an economic war between the states." In testimony before the Senate Subcommittee on Intergovernmental Relations, Maguire detailed the harmful combined effects of high energy prices and federal fiscal policies on energy-consuming states.

"The fiscal advantage accruing to certain states -- particularly those with oil, gas, and mineral revenues -- is so large, that the geographic allocation of economic resources is being severely distorted," Maguire said.

According to Maguire, this misallocation of resources has enabled Alaska to retire its income tax. Employment in Montana and New Mexico has grown 2.5 to 4 times faster, respectively, than in Maguire's home state of New Jersey. Yet New Jersey receives only 69 cents in federal services for each dollar paid in taxes, while Montana receives $1.18 and New Mexico gets $1.91 for each of their dollars.

Maguire cited two prime examples of federal encouragement of such fiscal imbalance between states. First, by counting state severance tax revenues as part of a state's "tax effort", the federal government boosts the amount of revenue-sharing dollars allocated to energy-producing states.

Maguire asserted that, on top of that inequity, a loophole in the Windfall Profit Tax Act permits oil companies to deduct millions of dollars in state severance taxes from their federal tax bills, allowing producing states to share further in the trillion-dollar oil decontrol plan at the expense of energy consuming states: "Before the oil is taxed; before the federal government can raise the revenue; before the monies are disbursed throughout the nation; the oil producing states can siphon off their oversized rewards from decontrol."

Maguire argued that, faced with shrinking federal assistance, consuming states can little afford the additional transfer of their energy dollars to producing states. He proposed to the Committee that Congress impose limits on state severance taxes, and scrutinize carefully the possible impacts on fiscal disparities between states of proposals to amend the tax code and to deregulate natural gas prices. "There is no reason why the federal government should continue to provide perverse rewards and subsidies which further tilt the already alarming imbalances," Maguire concluded.

Senator **Durenberger**. Our next witness will be Sally Streiter, vice president, National Economic Research Associates, Inc. Sally, I am sorry for what is happening with the time. I did read your entire statement, including all the attachments. I have a number of questions about it. It is an extremely well-done statement on the problems. As you pointed out in your written statement, which will be made a part of the record, for various reasons you have a great deal of personal familiarity with the situation in Montana. This adds to the value of your testimony.

We appreciate your being here. You may proceed.

TESTIMONY OF SALLY HUNT STREITER, VICE-PRESIDENT, NATIONAL ECONOMIC RESEARCH ASSOCIATES, INC.

Ms. **Streiter**. Thank you. It is a pleasure to be here. I would like to say, in common with several other witnesses, I also was involved in the *Commonwealth Edison Co.* v. *Montana* case. In my case, most of the research was done for counsel to the various utilities which brought that case, although not all of those utilities necessarily agreed with everything that I had to say.

I went to Montana and visited every mine in the State. I am not as familiar with the situation in Wyoming. What I attempted to do in my written testimony is simply stick to the facts that we developed about the impacts of the Montana tax. What I tried to do is ask myself what questions I would be interested in if I were a Congressman and, of course, I tried to address those questions which you specifically asked me to address.

Montana's tax is one of many severance taxes. Certainly in terms of its level, it appears to be the most audacious one attempted.

I have listed 10 questions. I will give you brief answers to them unless you prefer, in the interest of time, that I simply let you go through the testimony where I develop the answers in detail.

Senator **Durenberger**. Let me start with severance taxes in general and include the most audacious case which you mentioned. Can you address the aspects of severance taxes generally which may be particularly pertinent to a congressional deliberation? We have asked other witnesses about the Supreme Court charge to the Congress. We have discussed the various approaches which have been suggested to us and have looked at the issue of coal separately from oil and gas. Can you suggest some alternative course of action which we should follow in finding the appropriate national interest? In what way should we apply that to a State severance tax?

Ms. **Streiter**. I don't know that I have an answer to your question. However, I do have several thoughts that partly developed out of the discussion this morning. One is that there seems to be two separate types of issues which the Congress might want to consider. I have mainly addressed the question which economists would consider relevant: Is this tax messing with the markets? Is it increasing the price, and reducing the production?

If a tax is doing that, then the Congress might consider that it is just a national pastime, in the interest of equity, or something like that; or it may consider, in principle, it is quite dangerous. I think I have stressed here, and I do believe that there is a possibility of ever-increasing taxes, further shifting of production and increasing consumer prices, that sort of thing—an impact on real resource allocation. However, it is one of the main worries about severance taxes in general.

As far as I can make out, taxes on oil are not necessarily messing with the oil markets. In my view, OPEC sets the oil price and the Alaska tax has very little to do with the amount of oil produced. However, it does have a great deal to do with the relative richness of the State.

On that issue, I really don't have very much to say to you at the moment, but I can develop data. It is my job to develop data. Those two issues are really quite separate. The issue of whether some States should get richer at the expense of other States because natural resources suddenly become more valuable, is separate from the issue of whether a tax is messing with the markets and affecting production and prices.

Senator **Durenberger.** Maybe it was an unfair question, but I tried to get Senator Melcher to elaborate on the ways in which the costs of extraction, processing, transportation, and so forth, are being addressed through means other than the severance tax. You addressed this issue in your statement in various places. It would be very helpful to the subcommittee if you could pull it all together in one place for us. Starting with the internalization of costs through the regulatory process and then going into various State and Federal programs, could you show us specifically how you arrived at the conclusion? You can correct me if I am wrong here. You stated that at best 1½ to 2 percent severance tax is necessary to offset those costs including appropriate costs of general government.

Would it be possible for you to do that for the subcommittee?

Ms. **Streiter.** I can do it. I can do it quite briefly now. Senator Melcher listed off all the things on which the taxes were spent. Although he says there are lots of others, there aren't many. The total collected so far by Montana tax is somewhere in the realm of $135 to $140 million of which a big portion was collected during the last year.

When you consider that those schools are paid for with cash, his total expenditures so far come to 3 percent.

Senator **Durenberger.** Three percent?

Ms. **Streiter.** $8 million—I gave you the wrong number. It is $250 million collected so far; $8 million has been spent, which comes to something like 3 percent of what has been collected, or 1 percent of the value of the coal. But that is cash payments. Our number assumes that you bond expenditures over 20 years so our number comes out lower.

His numbers are not wrong. That 2 cents a ton is an old number. It would be 4 cents a ton now. We then added in the direct costs to State governments. Most of those are paid for by billing the mining companies, so we didn't count those. We counted the ones not paid for by billing the mining companies. That is another 2 cents a ton, 4 cents in current dollars.

The third thing we considered is the number of people coming into the State, the increase in population. We didn't include employing the local unemployed as a cost. We included bringing new people in, for whom you have to build new infrastructure, for whom you have to build new schools, and so on.

We counted State services for them at the average per capita cost of State government. That is an additional 2 cents a ton or 4 cents a ton in current dollars. The whole thing comes to about 1½ percent.

Senator **Durenberger**. I would like to insert at the end of this hearing record an article from the January 1979 edition of Planning titled "Communities and Energy Developers Can Work Together."[1]

One of the problems, which you alluded to in your testimony, with a very high severance tax is that it does have the effect of eliminating production if there are alternative sources for the mineral. Thus it impacts adversely on the value of leasehold interest which, in the case of Montana, impacts adversely on the Federal Government.

Could you briefly deal with that issue? Could you put it into a perspective for those of us trying to find a national interest in this area and a way to address that national interest?

Ms. **Streiter**. It is just the same essentially as the deduction from the windfall profits tax. If you can deduct the severance tax from the windfall profits tax, then the State can increase the amount it takes and the Federal Government, therefore, takes less. It is very much the same with the leases. If the Federal Government wants to take the lease money and the Montana tax is there in place, nobody can bid as much for the leases.

Given all the other things that have gone on, and given that the Federal Government hasn't leased anything to speak of since 1971, it probably missed its chance. Maybe other people would have grabbed the rents. Over the long haul, it would certainly lose its lease bonus, particularly if States then raise the tax again.

Senator **Durenberger**. Let me ask you next about your contrasting the Montana tax with the North Dakota tax. Do you know what the current tax in North Dakota is on coal and lignite?

Ms. **Streiter**. I believe it is a fairly complicated formula and not a percentage formula. It used to be about 25 percent. I believe they reduced it to something like 23 or 22 percent.

Senator **Durenberger**. One of the distinctions between lignite and Montana's low-sulfur coal—and between Montana's low-sulfur coal and higher-sulfur coal in other parts of the country—is the energy value measured in Btus. As I understand it, you will need to have an awful lot of lignite to do what a smaller amount of Montana low-sulfur coal does. That holds true to the comparison of Montana coal and other coal.

Just dealing strictly with a percentage on value is not necessarily a fair way to compare one State's severance tax with another. Am I wrong?

Ms. **Streiter**. It depends on what you are trying to compare. Comparing a tax on value is much more sensible than comparing a tax on Btus; but the difference, in my mind, between those two—I am not a lawyer. I am a commonsense person when it comes to this.

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[1] See page 422.

If a State chooses to tax itself, that is different. If they want to pay for the State services through taxing their own coal which they use, as far as I am concerned, that is fine.

Senator **Durenberger**. I am not as familiar as I should be—but we may be made more familiar tomorrow—with the situation. As I pointed out earlier a great deal of—let's just call it for the sake of classifying it—North Dakota coal, while it may be mined in the State and may be used in the State, it is really benefiting people outside the State. Therefore, in some indirect way the tax is being exported to the people outside the State—principally my State of Minnesota.

Clearly, a lot of our electric power is generated in the lignite fields of North Dakota. I would assume that a portion of that North Dakota severance tax is being exported to Minnesotans in the price of electricity. Have you looked at that issue enough to clarify my understanding of the situation?

Ms. **Streiter**. No. If it is exported to Minnesota, you get the same sort of questions: Does Minnesota have the power to go elsewhere; or does it have long-term contracts on top of which a tax was put? Once you have a long-term contract fixed, it is very expensive to get out of it. You are effectively monopolized with respect to that tax. I think that is something Congress might also want to look at, the question of grandfathering existing contracts.

If you are trying to tax, you should tax something on which people are very elastic. The people most penalized are those who have already signed the contracts and the cost of getting out of the contract is very high. You might consider grandfathering as a way out of some of these problems. If people are willing to pay, knowing what the tax is, let them go ahead and pay.

Senator **Durenberger**. The next one I didn't understand—and didn't take the time to reread—is your umbrella theory with regard to Montana's tax. The umbrella theory is briefly described here. Can you describe that theory for us?

Ms. **Streiter**. Let's say that Montana coal costs $10 to produce. These days it does roughly. Wyoming coal is more expensive. Let's leave aside the size of the States and the fact the transportation costs may be different.

There are two mines roughly 5 miles apart—one in Wyoming and one in Montana. If a 30-percent tax is put on the coal that costs $10 to produce, that producer has to get $13 for the coal from the next consumer who comes along. Incidentally, the producer will prefer to produce the $11 coal in Wyoming, because he can get more than $11 since the market is paying $13. He can sell anything from Montana at $13.

Unless Montana is knocked completely out of the picture, you have an umbrella between $11 and $13 to raise the Wyoming tax. Actually, if you look at the percentage between $11 and $13, it is 17 percent, which is what the Wyoming tax is. It happens to work out that way. Roughly, that is what has happened. The Wyoming Legislature can raise the tax just below the Montana tax to be able to pull in increased production, which is what has happened.

New Mexico doesn't quite have as much flexibility. They couldn't get away with raising it quite as high because people wouldn't flock to them as quickly. However, if Montana and Wyoming are going to move up, they can move up. Once we have gone around once, Montana is back in the position of getting new contracts because it is relatively less expensive. Then, off it can go again.

Senator **Durenberger**. Let me ask you another question which will put this back into a federalism context. My impression of the complicated North Dakota taxing situation is that one of the recent increases in the tax created some political problems in the State. Those in the West who are supplying the lignite are not benefiting to the degree they think they should. The taxes are spread throughout the State and are being used particularly heavily in the Eastern part of the State where there are a number of general government costs to be met.

Senator Wallop's introductory statement of S. 700 made quite an argument for the local ad valorem taxes as being different from a State severance tax. He talked in terms of bureaucratic complications and an awful lot of paperwork. He led me to believe—if I were inclined to do so—that we are creating, as we move toward State severance taxes and away from ad valorem taxes, substantial inequities within States as between local and State governments.

Have you looked at that issue at all? Are you able to comment on it at all?

Ms. **Streiter**. In Montana there are really only two major coal counties at the moment. One is Rosebud County and the other is Big Horn County, which is next door.

Although he is right, they didn't reduce the mill levy after 1975; they reduced it before 1975. Between 1970 and 1975 it tumbled to very low levels. It hasn't gone down since. The State came in and said, "We will put the tax on; we will take the revenues; and we will give some back." So then the levies, which dropped to what the Government required, didn't go any lower. I don't think it went much higher, either.

It seems like a wider spread of the goodies might be appropriate for a State's policy. It might also be appropriate for the Federal Government's policy.

Senator **Durenberger**. One of the statements which Senator Melcher made—if I can paraphrase him, or come close to quoting him—is that we have to let the marketplace work. We should let electric utilities decide whether to burn Montana coal.

In your opinion, what will the market actually do?

Ms. **Streiter**. Well, what the market has shown so far is that it has moved away from Montana. I think I said in my testimony, aside from economies, there is the question of pique—the utilities are really angry about this tax. The amount by which production has been reduced is somewhat more than I would have predicted. I would have predicted half.

The fact is we let markets work in the regular trade sense, except where you have monopolization. Where you have monopolization, you have antitrust laws. States can't be subjected to antitrust laws. However, the same idea could inform the Congress while it is trying to decide what to do about this. You let the markets work until somebody who has significant market power comes in and abuses their privileges. Then you try and stop it.

Senator **Durenberger**. Thank you very much for your testimony. I appreciate your interest in the problem and I assume it will be a continuing interest. We are going to need to call on you for your advice and assistance from time to time. Thank you very much.

Ms. **Streiter**. Thank you.

[The prepared statement of Ms. Streiter, with attachments, follows:]

PREPARED STATEMENT

of

SALLY HUNT STREITER

Vice-President

National Economic Research Associates, Inc.

It is a great pleasure to have the opportunity to present my views to this Committee. Last year at this time I testified before House and Senate Committees on legislation designed to limit ad valorem taxes on energy sources. At that time the Montana Coal Severance Tax was being litigated and the litigation was before the United States Supreme Court. The court issued its decision against the plaintiffs less than two weeks ago. My testimony is based on a great deal of research done for counsel to several electric utilities in connection with that suit, although not all of those utilities necessarily agree with everything I have to say. I have made a through study of the coal severance taxes in Montana and have visited all the large mines in that state, but am frankly less familiar with the situation in Wyoming.

My testimony will not attempt to address what is constitutionally possible or desirable. Instead I will simply stick to discussing the facts of the Montana coal tax and the implications that I would draw as an economist from those facts. I have asked myself what questions I would be interested in if I were a Congressman—including, of course, the questions you specifically asked me to consider. The Montana tax is one severance tax of many, but it is the most audacious that I am aware of; if any severance tax is a candidate for being scrutinized by Congress, the Montana tax must come high on the list.

Here are the questions that I am assuming you would want to ask about any severance tax. The first four questions are what I would consider to be threshold questions about whether to investigate a tax at all.

(1) Is the tax tailored to hit exports?

(2) Is it levied by a state with substantial market power in the resource?

(3) Is the tax raising revenues in excess of the costs imposed on the state?

(4) Are the taxes on the industry in question in excess of taxes on all other industries doing business in the state?

The second set of questions address the issue: Does it matter? Is the tax having any impact on the economy or energy policy or anything else?

(5) Is the tax a tax on economic rents or windfall profits?

(6) Will the tax lead to a domino effect of ever-increasing severance taxes?

(7) Does the tax affect the amount of the resource produced?

(8) Does the tax affect the price to consumers of the resource?

(9) Who pays the tax?

(10) Are there other aspects of the tax which might be particularly pertinent to Congressional deliberation?

Let me first answer these questions in summary form for Montana then I will expand on my answers.

(1) The Montana tax is clearly tailored to hit exports. The legislature knew that 90 percent of the coal went out of state. This is not true for example of the North Dakota tax, where virtually all the coal stays in state.

(2) Montana has substantial market power. This is not only because it has 25 percent of United States coal and 50 percent of low-sulfur coal, but also because it has long-term contracts, and because of geography, and the cost of transportation. Our estimates suggest that this market power is such that Montana could raise the tax to 100 percent before losing revenues.

(3) The tax raises revenues vastly in excess of any cost imposed on the State by mining activity. In addition, all these costs are already met four times over by non-severance taxes, and four times by the State's share of federal monies from coal.

(4) The taxes on coal are about thirteen times the size of taxes on the average of all other industries.

So in the case of Montana, all the threshold questions are answered "yes." Now, does it matter? Does it make any difference?

(5) The tax is not a tax on economic rents or windfall profits. The Montana legislature thought is was taxing windfall profits: instead it was probably creating windfall profits in other states which the other legislatures can then tax away in a tax-go-round. If a legislature wants to tax windfall profits the best thing to do is to create a windfall profits tax, not a severance tax.

(6) The Montana tax is actually a "windfall profit creating tax." For in raising its tax, the Montana legislature shifted some production to other states and raised market prices. This then created an umbrella under which producers in other states could raise their prices and collect windfall profits: the state legislatures can then come in and tax the profits away. This has already begun to happen. After one round of this, Montana will in all likelihood regain it market share, and can start all over again. Of course if the Western states cartelize, the taxes can be raised higher faster.

(7) A 30 percent tax can hardly fail to affect the amount of coal being produced: In my view the very substantial slowing of

Montana's coal production compared with pre-tax projections is largely a predictable result of a tax that size.

(8) Does the tax raise prices? On pre-tax contracts for Montana there is no question that it did: as for post-tax contracts, there have hardly been any so it is hard to tell what has happened to Montana prices. By Wyoming production is comfortably ahead of projections, and Wyoming coal is more costly to mine. So customers who shifted to Wyoming are paying more than they would have without the Montana tax.

(9) Who pays the tax? Careful economists rightly point out that this is a complex question. But to be simple, one has only to ask the following: in a competitive market where costs of production do not vary greatly, it is possible for all or even most producers to be making long-run excess profits equal to 30 percent of the price? If not, most of this tax must be passed on to consumers. Furthermore, when the Federal Government finally opens more coal lands to leasing, I predict that it will find that the tax is also shifted back to lease bonuses, which will be very small on all but extraordinarily good leases.

(10) Does the Congress have a particular interest in this tax? It may have for three reasons: One, 75 percent of Montana's coal is on Federal lands: the tax deprives the Federal Government of rents that might accrue to Federal Lands. Two, Congress has pushed energy users into coal: it has done this indirectly in deregulating oil and gas prices and also by other more direct legislation prohibiting oil and gas use. In enacting environmental and mine

safety laws Congress pushed utilitities and other users into low sulfur strip mined coal. It has helped create the monopoly position which permits the Montana tax to exist. Three: it has generously financed all the costs associated with development.

From all this I would conclude that the Montana law does affect access to Montana coal, does raise national coal prices, and will lead to a domino effect and escalating coal prices.

Let me now visit these questions in more detail. Where possible I will include consideration of Wyoming as well as Montana.

(1) Are the Taxes Tailored to Fall on Out-of-State Consumers?

The answer to this question is clearly yes—a little more clearly yes in the case of Montana and, perhaps, a little less so in the case of Wyoming. First, Montana. In 1974 and in 1975, when the Montana legislature deliberated on the 30 percent tax, it took the pains to have one of its researchers examine all of the existing coal contracts to see whether they contained pass-through clauses. The Montana courts and United States Supreme Court may think it silly that a decision to uphold or strike the tax be based on the "vagaries of contracts," but the Montana Legislature certainly did not think this was an irrelevant consideration. When this tax was passed, the State knew well that the vast majority of the coal was exported under long-term contracts with pass-through clauses. They were right. Well over 90 percent of the coal was and is exported to the Midwestern states and Texas.

At the time the Montana 30 percent tax was passed, Wyoming coal severance taxes totalled about 7 percent. Looking north to the example of Montana, Wyoming quickly raised the tax rate to 17.5 percent. Since that increase, Wyoming's Governor has twice attempted to add 5 more percentage points. As in Montana, Wyoming knew that most of the coal would go to electric utilities in Midwestern states where sulfur regulations prevented the use of local coal; and by utilities in Southwestern states who were federally constrained from continuing to depend on their own vast oil and gas reserves. Wyoming also expected most of the tax to be exported. By contrast, North Dakota, whose tax level rose at one point to about 25 percent of value, was not tailoring a tax for export: almost 100 percent of North Dakota's coal is used in state. This state recently reduced its tax level.

(2) Do Montana and Wyoming Enjoy Significant Market Power?

This question is important because unless a state has market power a tax will simply force producers and consumers to go elsewhere: it will fail to raise revenues. Could Minnesota levy a 30 percent tax on butter or Kansas on corn?

Montana and Wyoming contain 40 percent of total United States coal reserves. Most important, Montana and Wyoming together contain fully 68 percent of the nation's low sulfur coal reserves. The coal occurs in thick seams close to the surface and is the cheapest in the country to mine. But this alone does not give them market power: in fact up until 1970, these two states produced only a tiny fraction of United States coal supply. Yet they are expected to produce half the incremental coal between now and the end of the century.

Why then have Montana and Wyoming only recently begun to acquire the dominant position they will surely occupy in the years ahead?

First, in the years prior to 1970, Western and Southwestern demand for coal was low. Gas in the Southwest and oil in California were cheaper than coal, which had to be transported long distances. The coal regions themselves were sitting on cheap hydro power. But as incremental hydro resources ran out in the 1960s, Western growth had to be met by coal or nuclear power.

At about the same time, air pollution control laws began to require sulfur controls, culminating in the 1970 Clean Air Act. Montana and Wyoming control 68 percent of the low sulfur coal in this country. Improvements in stripmining technology reduced the cost of Western mining, while the Mine Health and Safety Act of 1969 made underground coal more expensive, offsetting to some extent the high cost of transporting Western stripmined coal and making it more competitive.

The OPEC embargo of 1973 and subsequent price rises in oil and gas made coal a relatively more attractive option and secured its rescue from long-term stagnation. Together with the perhaps temporary demise of the nuclear option, this leaves coal as the only important source of incremental electric generation. And it is in Montana and Wyoming that the bulk of economical low-sulfur coal reserves are to be found. They need not fear competition from alternative energy sources, within wide limits.

So, Montana and Wyoming have market power: first, because of Mother Nature they contain the majority of premium coal reserves in this country. And, second, a major reason their reserves are premium is because this Congress has helped to make them so.

By 1975 Montana and Wyoming knew with certainty that their sister states would be flocking to them for coal. In 1975 they contributed only 10 percent of total United States coal production. Within two years, their contributions were 15 percent. By 1990, these two states are expected to account for 35 percent of United States production.

Long-term contracts have already been signed for over 100 million tons a year of additional coal from Montana and Wyoming, double the current level, and 68 utilities in 23 states expect to be purchasing Montana and Wyoming coal by 1987. As Exhibit 1 shows, this includes all but three states west of Chicago, and Michigan, Indiana, Ohio and New York to the East. So the projections of the crucial role of Montana and Wyoming are not the aberration of some DOE model: they are verified to 1985 by contracts and firm plans for supply to generating units under construction. At 1979 coal prices, Montana and Wyoming would receive $360 million in severance tax revenues in 1987. $350 million of this will be paid on coal which is exported to other states.

This robust market for their product means that both Montana and Wyoming may levy very high ad valorem taxes individually, with the confident expectation of growing state tax revenues: in combination, their ability to raise the tax rate would be almost without limit.

Just how wide those limits are depend, of course, on how price responsive suppliers and consumers are. Economists refer to this price response as elasticity—and though the Supreme Court may be intimidated by its complexity, it is really quite simple.

A severance tax, like any tax, serves to raise the price of the good being taxed. As that price increases, consumers will go elsewhere to buy goods and producers will move to locations where their production costs (including taxes) are lower. This is precisely what has happened in Montana since the 30 percent severance tax was passed. If Montana mines are losing potential production, it is because there are competitors; if there are competitors, the producers have little market power individually. Yet even so, Montana as a tax collector has sufficient power in the coal market that it can continue to raise tax rates and increase tax revenue even while losing production.

This point is not always easy to see, so let me explain it: suppose a 35 percent severance tax as compared with a 12.5 percent tax results in a loss of

25 percent of production. Montana is still better off with 35 percent of 75 percent than it would be with 12.5 percent of the whole. It would be even better off with a 50 percent severance tax or a 60 percent severance tax. At some point, of course, a high level of tax becomes counter-productive to the state imposing it. (As Laffer has convinced the Administration, higher tax rates can reduce tax revenues.) If production shifts sufficiently, tax revenues may decline as the tax rate increases. However, our estimate of the market power of the State of Montana acting alone suggests that a tax of up to 100 percent could be levied before there was actually a reduction in tax revenues. What then limits the size of severance taxes? Not the voters and not, so far, the market. Other states which do not have the same market dominance would find a much greater loss of production, and their maximum feasible tax revenues, if they acted alone, would be associated with a much lower tax rate. But Montana's tax is an umbrella: is is a windfall to the other states, who are thereby granted latitude to raise their own taxes.

Neighboring Wyoming, where the total ad valorem tax is set at 17.5 percent, is currently welcoming new mines and tax revenues, and takes in about twice the absolute amount of tax as Montana. If it chooses to act in concert with Montana—and there have been several legislative proposals as well as approaches by the Montana legislature for a unified front—the two states together would in all probability have no limit, not even 100 percent, to the tax rate they could impose. There would be some shifts of production to regions where mining is more hazardous, more degrading to the environment and more expensive, but the legislature would still be able to increase its tax take virtually without limit. This is entirely due to the dominant position of the western states astride the coal supply. Other states, whose ability to raise severance taxes independently is limited, will be given a flexible and wide umbrella under which to raise their taxes, and the price of coal will be greatly increased.

(3) Do the Revenues Generated by the Tax Exceed the Costs?[1]

Yes, many times over. It seems to be a matter of simple justice that states should be allowed to set taxes on their energy exports to recover the environmental and social costs associated with energy production. Consumers of energy should not be permitted to turn the Western states into energy colonies: they should pay the full economic, environmental and social costs of the energy they demand. Interstate commerce should stand on its own bottom and pay its own way.

But the costs imposed on Montana by coal production are very low. Regulatory statutes, of which Montanans are justly proud, ensure that environmental costs are already internalized--paid for by producers and, hence by consumers in the price of coal: social costs, (hospitals, schools, etc.) plus the direct costs of regulating mines plus a share in general state government come to under 2 percent of the value of coal in Montana. A variety of other taxes already cover these costs.

If these estimates of impact seem unbelievably low, here are the main reasons for it: first, mining in Montana is extremely capital intensive. One miner can mine 40-50,000 tons of coal per year compared with the national average of 3,400 tons per miner per year. Hence, increases in population are small, (we estimated 1,500 total population increase for 50 million tons of increased production) and increased cost is very small when expressed as cost per ton of coal.

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[1] This section is based on our analysis of the costs of mining in Montana. We have not examined the costs to the state of Wyoming. But if the results of a recent Congressional Budget Office report are any indication, the results may be quite similar.

Second, our analysis takes account of existing unemployed population—it does not assume that all new employment will come from immigration. In Montana, for example, half the employment at one of the five mines is of Crow Indians who have limited employment opportunities on the reservation. We did not count reduced unemployment as an offset to costs, but neither did we count employing the local unemployed as a burden on Montana.

Third, our estimates are of the peak year impact of coal mining, not the impact of conversion facilities such as electric generating plants or coal gasification facilities. Since we were studying the impacts of mining coal which would be shipped out of state, the impact of conversion facilities was not relevant. However, Krutilla's[2] analysis, which did include gasification plants, concluded the tax revenues generated to state and local governments would suffice to provide for public costs without the need for a severance tax.

I would like to take a minute to clarify the widely used figure of two cents a ton. The two cents a ton refers to local government expenditures. Furthermore it is in 1975 dollars. The current number would be more like four cents a ton but it would still be half of 1 percent of the value of the coal. The major impacts of mining are local impacts such as schools, infrastructure, hospitals, fire protection resulting from large increases of population on a relatively small base, and these we have investigated carefully.

But what of State government expenditures directly attributable to coal mining? We have not tried to track down the impacts in detail but they are clearly small. The State reviews mining plans and prepares environmental impact statements, but charges the companies for these activities. It also employs mine inspectors (a dozen in 1978). If we assume that a total of 30 people were employed somewhere in State government at an average salary of $20,000 per annum to regulate coal development, this would amount to a further half of 1 percent.

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[2] J. V. Krutilla and A. C. Fisher, Economic and Fiscal Impacts of Coal Development, Northern Great Plains, published for Resources for the Future by Johns Hopkins University Press, 1978.

Coal mining should also bear a fair share of costs to the State government, the benefits of civilized society. The mining companies of course do pay the corporation license tax and the resource indemnity tax, and property tax. But, clearly, the new population imposes some incremental costs on the State; at some time they will use the colleges, libraries, centers for the aged or hospitals which the State has constructed and which it maintains. The new population of course also pays personal income tax, liquor tax, cigarette tax, etc. and there is no reason to suppose that immigrants would not pay their way in this respect. But to fix the magnitude of the possible cost, the average State expenditure per capita in Montana is $585. The total for the newcomers amounts to yet another half of 1 percent.

The best, but still conservative, estimate is one and one-half percent of value. If we take the maximum estimate for local costs (when all new employment immigrates) and the maximum for direct State costs and indirect State costs, it is hard to get to two and one-half percent of value. Actually Montana's own expenditures from the severance tax for the impacts of coal mining have never run as high as the two and one-half percent of value allocated from the severance tax for alleviating impacts, which offers indirect confirmation of our estimates of costs.

Further confirmation comes from a report released by the Congressional Budget Office.[3] C.B.O. compared the costs which would result in a "worst case" situation with the minimum revenues that would accrue to some 10 states likely to experience growth in coal production. Since it was a worst case scenario, it came up with costs substantially in excess of those I have just presented as our best estimate. However, even these very high estimates of costs represent the equivalent of a 3 to 4 percent severance tax in Montana and Wyoming. Also our analysis of the C.B.O. report indicated that the 12.5 percent limit suggested by last year's proposed legislation would be more than sufficient to cover costs for each of the ten states for every year between 1980 and 1990.

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[3] The Congress of the United States, Congressional Budget Office, Energy Development, Local Growth and the Federal Role, June 1980.

A word here about environmental costs: We were well aware at the outset of this study that there might be environmental costs associated with mining—that either the State might have to make expenditures to repair damage, or that damage might remain unrepaired, imposing a real cost, if not a monetary cost, on the people of the State. However, after careful review of numerous (30-40) environmental impact statements and mining plans we have concluded that the laws, both Federal and State, governing Montana coal production, are so stringent as to make it virtually impossible to inflict any lasting environmental damage. The consumers of the coal are, as is right, paying the environmental costs in the price of the coal.

As Exhibit 2 shows, we have a variety of mechanisms already in place at the national level that ensure that, in the very unlikely event that some now-unforeseen environmental costs must be borne by the state, these will not be an undue burden on Montana's population. Two federal taxes levied on coal production provide funds that are funnelled back to states to offset potential deleterious effects of mineral production. The Surface Mining Control and Reclamation Act of 1977 levies a 35 cent tax on each ton of strip-mined coal and 50 percent of this money is returned to the state from which it originated for the purpose of reclaiming strip-mined land. An additional 20 percent of fees my become available to states under the Rural Abandoned Mine Program. The Surface Mining Act program began operating on January 1, 1978; Montana and Wyoming had production levels to warrant receipt of $15 million in 1978, and $18 million in 1979 from this fund. Although these funds are to be used for reclamation, the surplus of revenues over reclamation costs may be used for socio-economic impact costs.

At present, there are three state production or ad valorem taxes in Montana, the Gross Proceeds Tax, the Resource Indemnity Tax and, of course, the Severance Tax. The rate of taxation for all three taxes together is approximately 35 percent. As Exhibit 2 shows, in 1979 the two non-severance taxes alone generated revenues equal to four times the environmental and social costs associated with coal production.

So, to summarize: the costs to Montana of coal mining are met eight times over by existing Federal and State revenues from coal: the severance tax greatly increases that ratio: the costs are met 35 times over.

(4) Are Taxes on the Coal Industry in Excess of Taxes on All Other Industries Doing Business in the State?

Apparently so: Professor James Papke of Purdue University testified before a Congressional committee last year that according to his calculation the coal industry is taxed some 13 times more heavily that all other industries doing business in Montana. On average, Montana's business taxes represent 1.3 percent of total production costs. The coal severance tax alone is many times higher than this. Interestingly, the tax burdens on other mining operations also exceed the 1.3 percent average, but even so still amount to less than 5 percent. For oil and gas, where Montana does not possess important market power, state taxes amount to only 3 percent.

I pause here to remind the reader that these four questions were my "threshold questions:" is the tax tailored, does the state have significant market power, is the tax in excess of costs, and is it in excess of taxes levied in similar industries? I call these threshold questions because I would be inclined to ignore, for a variety of reasons, a tax which did not meet these tests. In the case of Montana my answer to all four questions is "yes." But does it matter?

As a constitutional law question, others are more qualified to comment; but from an economic perspective, I would remember the history of import tariffs. When European countries in the Twenties and Thirties imposed import tariffs to protect domestic industry, they found that neighboring nations imposed retaliatory tariffs. The net effect was to cut everybody's exports, to cut everybody's imports and ultimately to cut everybody's GNP. The "beggar-thy-neighbor" approach resulted in beggaring the entire neighborhood. It was this bitter experience that led nations of Western Europe to create a Common Market in which barriers to trade would gradually be reduced—gradually because it can be painful and uncertain to remove crutches to which one has grown accustomed, even though walking is ultimately so much more efficient than hobbling on crutches. So the rest of my questions examine the economic consequences of the Montana Severance Tax.

(5) Is the Tax on Windfall Profits or Economic Rents?

The Montana legislature introduced the idea of economic rent right in the legislation:

> [C] oal in Montana, when sub-bituminous and recoverable by strip-mining is in sufficient demand that at least one-third (1/3) of the price it commands at the mine may go to the economic rents of royalties and production taxes.

What is an economic rent, and why should Congress care about them? As the Court correctly defined it, an economic rent is "the difference between the cost of production and the market price of the coal."

An economic rent is not quite the same as a windfall profit, but so as to avoid confusion perhaps we could assume that they are similar. (A windfall profit is an economic rent captured by a producer: if someone else captures it, for example, the miners, the producers of mining machinery, the owners of the leases or the railroads, the economic rent becomes indistinguishable from the costs of doing business.)

It is widely assumed, and I think correctly, that the OPEC price rise of 1973-1974 led to a sudden rise in the price of coal which did not reflect an underlying increase in costs. However, in contrast to the oil market, the coal market has a relatively flat supply curve: this is another way of saying that new entrants to the coal market could produce coal at below the newly inflated price and would apply competitive pressure to reduce prices. So the excess profits or economic rent on coal due to OPEC would be likely to be whittled away by new entry. Of course a funny thing happened on the way to lower prices: everyone wanted their share of the economic rent: labor went on strike for higher wages, railroad rates rose, tough new strip mining laws were enacted for environmental protection and even the Federal Government got into the act by raising royalty rents. So these changes became embedded in the costs of production. I see no evidence that there are still OPEC-induced economic rents in the coal market.

This is important because in many circumstances it is true that taxing away an economic rent will have no impact on the current market price or on the amount supplied: I do not think for example anyone believes that the windfall profits tax on oil raised the price of oil: OPEC fixes the price of oil.

But Congress in the oil case was careful to tax windfall profits: it did not lay a blanket percentage tax on oil production. It recognized that even if there are windfall profits, the size will vary, and the marginal producer will be choked out of the market by a percentage tax; therefore old oil was subject to higher taxes than newly discovered oil, so as not to discourage supply. So I would say, if a tax is intended to be a tax on economic rents or windfall profits, let it be called a windfall profits tax and structured to capture windfall profits.

(6) The Question of Dominance or Tax-Go-Round

The Montana tax may not be taxing windfall profits, but I think it can be shown that it is creating them. If it costs $10 to produce a ton of coal in Montana and $11 in Wyoming, a 30 percent tax on Montana coal raises the price that it must fetch to $13. This leaves Wyoming producers able to charge up to $12.95 for new contracts and capture them all until new entrants force the price down. But what if Wyoming sees that lush $1.95 windfall profit and raises it tax? A 10 percent increase in the tax rate captures $1.10 (10 percent of $11), leaving the Wyoming producers just enough room to underbid the Montana producers, and keep some windfall profits of their own.

This is roughly what has happened. The Montana tax creates the umbrella for other states to raise their own taxes, even though they might not have had the market power to be the first to move. This is already happening. As I noted earlier, Wyoming has followed Montana's example and raised its tax to 17.5 percent. New Mexico recently raised its coal severance tax for the third time in the last three years. And, there is some evidence that other states are currently contemplating doing the same. We know of at least two states where the legislatures have directed researchers to measure the coal severance tax revenues they might acquire if they raised their tax rate to 30 percent.

Montana of course loses potential production: but when other States have gained enough captive buyers through long-term contracts, they can go in and capture the rest of the rent, restoring the initial relative position and Montana can once again enter the market, gain more contracts and start over again.

What limit is there to this process? Since very little of the tax falls on the citizens of the energy-rich states, we cannot expect their voters to throw out the legislatures. The power of the voters is irrelevant where, as here, the taxpayers are not represented. In fact the voters, as might be expected, uniformly love the tax.

(7) Does the Tax Affect the Amount of Coal Produced?

All indications are that the Montana tax has reduced the amount of coal produced from Montana. Projections prior to the tax called for 75 million tons by 1985 up from 25 million in 1974. Present production has levelled off at 30 million tons, which is even somewhat below what our projections, made in 1978, would have suggested as the effect of the tax. I would not discount the effect of uncertainty over future tax increases, or sheer pique, in explaining the additional shortfall. The reduction is sometimes explained by a general slackness in the coal market, but if this were so, the same should be true of Wyoming: however Wyoming's production, which was also 25 million tons in 1974, has since quadrupled. At 100 million tons in 1980, actual production is well ahead of older projections whereas Montana's is even below 1974 projections based on signed contracts: some contracts have been cancelled. Mines in Montana are running below capacity and planned mines have not been opened. In the five years following imposition of the Montana severance tax, there were only four new contracts signed, all for short-term supplies, as against 15 long-term contracts signed in the previous five years.

Perhaps it is Montana's business if it wishes to pursue policies which discourage development: but there are few good substitutes for coal since nuclear development has all but halted and oil and gas have been prohibited for electric generation. So reduction of output from the state with the lowest cost coal shifts production to states where production costs are higher, and where environmental problems are greater. It is as if Montana had built a steep hill around its borders: not impossible to cross, but costly.

(8) Does the Tax Raise the Price of Coal?

For those utilities who had already contracted for Montana coal before the tax was imposed, the tax clearly raised the price. But even for those consumers who entered the market after the tax was imposed, it must raise the price. Consider the example I gave earlier: if Wyoming coal costs $11 to produce when Montana coal costs $10, even if Wyoming does not raise its tax, and even after allowing for new entry, a consumer must pay $11 for coal. It is fairly clear that if a utility which would have bought Montana coal for $10 goes elsewhere when Montana raises the price to $13, the utility must be paying more than $10, or it would have gone elsewhere in the first place. Customers will pay more for coal even if they do not buy from the taxing state.

(9) Who Pays the Tax?

This is a question known to economists as the "incidence of the tax." Just because the law says the producers must hand over a check does not mean that they "pay the tax." Nor, because a contract says that the cost will be passed through can we necessarily infer that the buyer "pays the tax." This is because if a producer cannot sell coal at his customary price of, say, $10 plus tax he may choose to take a lower return on the deal and reduce his base price to $9 in order to get the business. In that case the contract will say $9 plus $2.70 tax: total $11.70; but the consumer will be paying $1.70 more than he would have without the tax. The incidence of the tax will be $1.70 on the customer and $1 on the seller. The customer "pays the tax," but really he pays only 63 percent of it.

Now, for contracts signed before the tax was passed, these deals had already been made, so the tax was simply passed through. If these customers made no more contracts with these producers, it is safe to say the customers paid the tax. But for taxes already in existence, calculation of the precise incidence of the tax can be a little complicated. In general through, there are a few things that can be said:

(1) Customers who have nowhere else to go (those with "inelastic demands") will end up paying most of the tax.

(2) For a state acting alone the demand will be more elastic than for states acting in concert (customers can shift from Montana to Wyoming but not much beyond that).

(3) Producers will pay little of the tax if the costs of mining are relatively similar between mines (this is called "elastic supply") because the pre-tax price will reflect the costs, and there cannot be much undercutting: they will all have to pass the tax along.

(4) Both elastic supply and relatively inelastic demand appear to characterize coal markets in Montana and Wyoming. Elasticity of demand for Montana alone is about -2, and elasticity of supply is about 5. If Montana were an island, this would indicate that new customers would pay about 60 percent of the severance tax, and new production would be reduced by 40 percent. But taken together, the elasticity of demand for Montana and Wyoming coal become much lower and the elasticity of supply much higher. Hence the incidence is slightly more complex: the customers pay most of the tax in higher prices, but Montana's producers suffer lack of revenues and excess capacity while Wyoming's producers reap extra profits (if Wyoming does not tax them away).

As to the Federal Government and other owners of the coal rights: normally they would stand to reap any economic rents in the form of lease bonuses when the land is put up for lease. If all the other factors had not been at work whittling away the OPEC rents the Federal Government might have reaped substantial revenues: it still may on particularly good land. But the tax effectively pre-empted any 1974 rents, and in any similar future situation would do so again.

(10) Are There Other Aspects of the Tax Which Might be Particularly Pertinent to Congressional Deliberation?

Yes, there are. First, as Exhibit 1 shows, by 1987 Montana and Wyoming will be collecting a minimum of $350 million from 95 million out-of-state consumers in 21 states. Is the problem important enough for Congress to worry about? After all, the tax does represent a small proportion of any individual consumer's utility bill. Of course, many worthy causes would be happy to be awarded a tiny fraction of the national utility bills, especially if it amounted to $350 million a year.

But Montana's and Wyoming's state tax revenues will grow not only because 95 million citizens in 21 states will be contributing $350 annually. These direct revenues will be augmented from indirect revenues, at the expense of citizens in the remaining 48 states. This is because Federal revenue sharing formulas are based in part on local and state tax efforts. Presumably, the theory is that federal funds should flow in greater proportion to those states willing to tax their own populations. But Montana and Wyoming have found a way to tax residents of other states and use those proceeds to garner a larger share of federal revenue sharing. This increment to Montana's and Wyoming's shares of the total federal pie will come at a time when that pie is not likely to be growing. Because of the increased flow from state severance taxes, Montana has already leaped from 16th among states in total per capita payments made to date to 10th in the nation in per capita revenue payments. Much of this change is due to increased state and local tax "effort," an important element in the revenue sharing formula.

Second, there is a more direct and immediate Federal interest in this case. We stand poised at a new era of Federal coal leasing, where the rich coal lands of the West, owned by the people of the United States, are to be reopened to reduce our dependence on foreign oil supplies. Seventy-five percent of Montana's and Wyoming's coal is federally owned. The immediate impact of the Western severance taxes on the bidding process will be to reduce the up-front lease bonuses which will be bid for federal lands. As I have mentioned, half of this money goes back to the states where the coal is located anyway. The western states want to take all of it.

Third, if Montana and Wyoming are now in the position to exploit out-of-state electricity consumers, it is partly because Congress put them in that position. The environmental and energy legislation which Congress has framed over the last decade are dependent on the production of low-sulfur Montana and Wyoming coal if they are to succeed.

At the same time that Congress has called upon these two states to increase their contribution to domestic energy supply, it has taken great care to assure that any adverse impacts resulting from that increase will be taken care of. As Exhibit 2 shows, there are currently four Federal programs in existence which are designed to compensate for these impacts. Our studies show, that at least in the case of Montana, the four programs alone contribute revenues which are four times more than what is actually required.

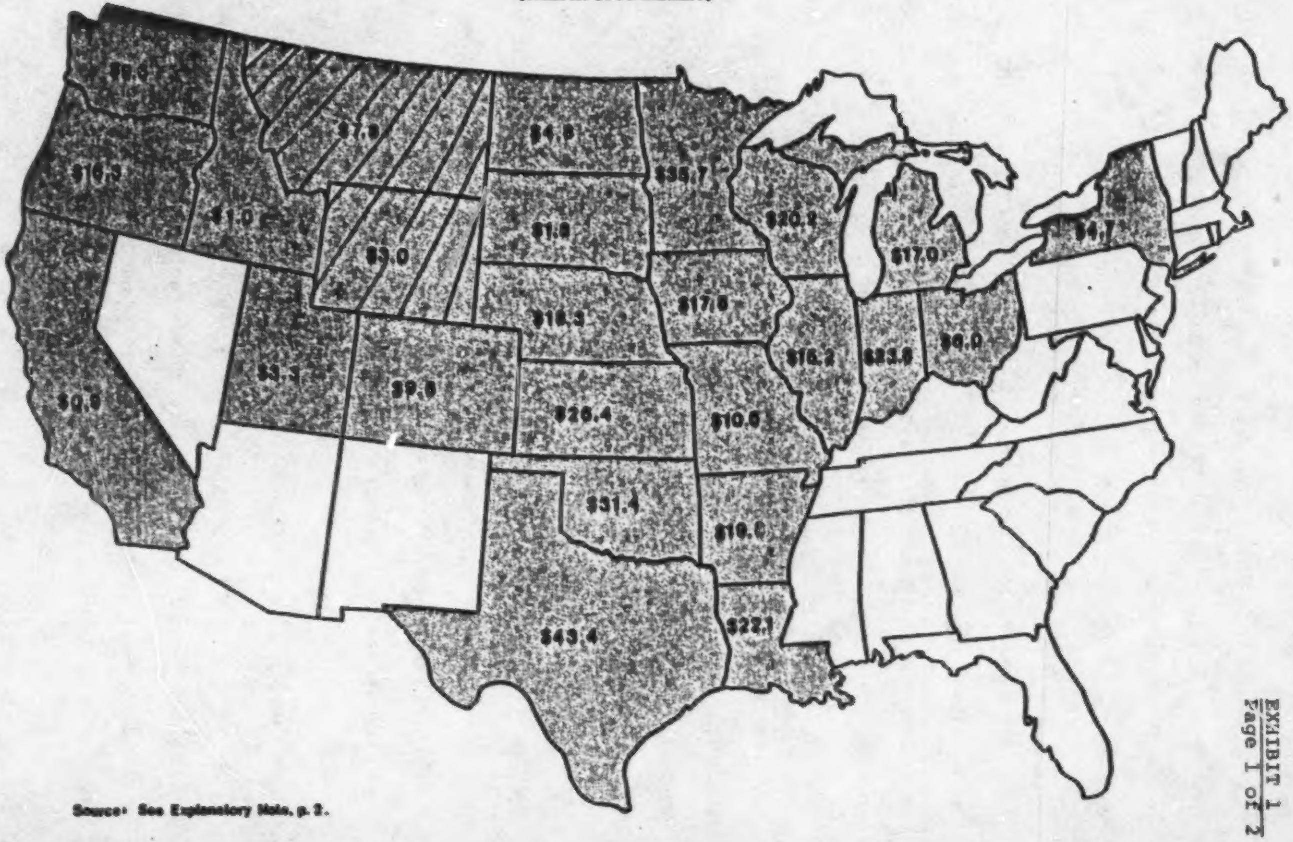
Conclusion

The problem is an important one: it involves large sums of money, just how large no one can tell. The coal states have the power to become our OPEC within. If Congress doesn't choose to protect the nation as a whole by limiting the size of these severance taxes now, the problem several years from now may be of such magnitude as to make solutions even more difficult to devise.

EXHIBIT 1
Page 1 of 2

ESTIMATED SEVERANCE TAX PAYMENTS TO MONTANA AND WYOMING IN 1987

(Million 1979 Dollars)


$9.6
$10.3
$0.9
$1.0
$7.9
$3.0
$3.1
$9.9
$4.9
$1.9
$18.3
$26.4
$31.4
$43.4
$35.7
$17.6
$10.5
$19.6
$22.1
$20.2
$17.0
$16.2
$23.6
$9.0
$4.7

Source: See Explanatory Note, p. 2.

EXHIBIT 1
Page 2 of 2

ESTIMATED SEVERANCE TAX PAYMENTS TO MONTANA AND WYOMING IN 1987

(Million 1979 Dollars)

The estimates in this Exhibit are based on actual deliveries of Montana and Wyoming coal in 1978 and demand for new units to be built between 1979 and 1987, as reported in a study prepared for the Department of Energy by Argonne National Laboratory.[1] State-by-state severance tax payments were estimated as follows:

Existing (1978) demand, that is for contracts which are currently being met, is assumed to remain in effect at its current level. Total severance taxes paid in 1978, as reported by the Montana and Wyoming Departments of Revenue, were allocated based on the share of 1978 deliveries to each state. 1978 payments were then escalated by a 10 percent inflation factor to determine 1979 payments. No further adjustments were made to allow for future price increases in current contracts.

Severance tax payments for supplies to new units reflect current severance tax rates (30 and 17.5 percent) and assume an average contract price of $10 per ton. These were applied to the state-by-state new demand for Montana and Wyoming coal to estimate total payments for new demand.

Both new and existing deliveries were adjusted to reflect shipments by wire. Total payments of $370 million in 1987 reflect the sum of new and existing payments.

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[1] Argonne National Laboratory, A Survey of Electric Utility Demand for Coal, August 1979.

EXHIBIT 2
Page 1 of 2

ESTIMATED NET BENEFIT TO MONTANA FROM COAL PRODUCTION

1979

		Costs	Income	Balance
		----(Million Dollars)---		
		(1)	(2)	(3)
COSTS				
Environmental				
1. Preparation and Review of EIS's	Paid Directly by Producers			
2. Air and Water Monitoring by Bureau of Mines				
3. Soil Testing by U.S. Forest Service and Montana State University				
4. Reclamation to Original Contour and Native Flora				
5. Replacement of Acquifers and Wells		$0.0		
6. Salaries of State Mine Inspectors		0.6	-	
Socioeconomic				
7. Local Services and Facilities		0.9		
8. State Expenditures		0.9	-	
(Total)		$1.8		
Total Environmental and Socioeconomic Costs			-	($2.4)
INCOME				
Federal				
9. Surface Mining Control and Reclamation Act of 1977				
- 50% of 35¢/Ton			$ 5.7	
- Abandoned Mine Program			2.3	
10. Power Plant and Industrial Fuel Use Act			0.3	
11. Mineral Leasing Act Amendments of 1977			0.8	
State				
12. Resource Indemnity Tax			0.9	
Local				
13. Gross Proceeds Tax			8.5	
Total Federal, State and Local Income (excluding Severance Tax)				$18.5
NET INCOME EXCLUDING SEVERANCE TAX				$16.1
SEVERANCE TAX			$66.9	
TOTAL NET INCOME IN 1979				$83.0

EXHIBIT 2
Page 2 of 2

ESTIMATED NET BENEFIT TO MONTANA FROM COAL PRODUCTION

1979

NOTES

Lines 1-5: For a detailed discussion of the environmental costs paid directly by the producers see the testimony submitted by Ms. Streiter.

Line 6: Assumes 30 state inspectors and other coal-related personnel are employed at an average salary of $20,000. Based on review of Montana State Budget.

Line 7: Includes costs of services and facilities for hospitals, social welfare, police, fire, sewage, solid waste, recreation, libraries, general government, water treatment and education as estimated by Argonne National Laboratory's Social and Economic Assessment Model (SEAM). These costs are calculated for the peak year of expenditures, for a growth in production of 50 million tons to 1983. Original estimate in 1975 dollars has been escalated to 1979 dollars and applied to an output of 32.5 million tons for 1979.

Line 8: The SEAM Model estimated incremental population of 1,500 for 50 million tons incremental production. Assuming these people pay no taxes but require the average level of services gives 2 cents per ton in 1975 dollars. Original estimates escalated to 1979 dollars and applied to output of 32.5 million tons.

Line 9: Under this Act, 50 percent of the 35 cents per ton Federal Tax is allocated directly back to the state and an additional 20 percent is available under the Abandoned Mine Program. Estimate based on 1979 production of 32.5 million tons.

Line 10: Title VI of the Powerplant and Industrial Fuel Use Act makes funds available to energy impacted states. Allocation is based on expression of need by state governors and is subject to approval by federal authorities. This amount is reported to have been paid in 1979.

Line 11: Under this Act, 50 percent of the royalties, bids and bonuses collected from production on federal lands is returned to the originating state. Estimate based on actual 1978 funds returned to Montana, and adjusted for the increase in production from 1978 to 1979.

Line 12: Estimate based on actual tax payments in 1976 and adjusted to refect 1979 production and price levels.

Line 13: Estimate based on actual tax payments in 1976 and adjusted to reflect 1979 production and price levels.

Severence Tax Payments: Actual tax payments in 1979 as reported on COAL-1 Forms submitted by the coal producers to the state.

Senator Durenberger. I understand that our last witness from the Bureau of Census has agreed to come back and be a part of tomorrow's hearing—because of the lateness of the hour. So at this time we will recess the hearing until 9 a.m. tomorrow.

[Whereupon, at 11:53 a.m., the subcommittee was recessed, to reconvene at 9 a.m., Thursday, July 16, 1981.]

FISCAL DISPARITIES

THURSDAY, JULY 16, 1981

U.S. SENATE,
SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 9 a.m., in room 3302, Dirksen Senate Office Building, Hon. Dave Durenberger (chairman of the subcommittee) presiding.

Present: Senator Durenberger.

Senator DURENBERGER. The hearing will come to order.

We will finish first with the agenda from yesterday and call Shirley Kallek from the Bureau of the Census. Ms. Kallek, we are sorry the hearing went a little long yesterday. We appreciate your willingness to come back. As I understand it, you will be followed by a panel of four, including Minnesota Congressman Jim Oberstar, and three other fellow Minnesotans.

TESTIMONY OF SHIRLEY KALLEK, ASSOCIATE DIRECTOR FOR ECONOMIC FIELDS, BUREAU OF THE CENSUS, U.S. DEPARTMENT OF COMMERCE, ACCOMPANIED BY JOHN T. COLEMAN, ACTING CHIEF, GOVERNMENTS DIVISION, BUREAU OF THE CENSUS

Ms. KALLEK. That is perfectly all right, Mr. Chairman.

Mr. Chairman, I am pleased to have the opportunity to appear before this subcommittee to describe the Bureau's program on State and local government tax collections. I am accompanied by Mr. John Coleman, Acting Chief of the Bureau's Governments Division.

I have a more detailed statement to be included in the hearing record. I will present only a summary of it now.

Data on severance tax collections of the States are obtained annually and quarterly. Currently, there are 33 States imposing such taxes. The number of States was fairly constant at 28 or 29 between 1965 and 1974, but since then 4 more States have added this provision.

Total revenues rose slowly from 1965 to 1973, as you can see in table 1 and chart 1 [1]—from $503 million in 1965 to $850 million in 1973 and to $1.3 billion in 1974—and accounted for less than 2 percent of total State tax revenues. (See table 2.) Since 1975, there has been a much sharper increase in revenues from the severance tax, with a 44-percent increase between fiscal year 1979 and 1980—from $2.9 billion to $4.2 billion. Of the 33 States imposing severance taxes in 1980, there were 8 States which collected $100 million or more. This accounted for almost 87 percent of the national total of $4.2 billion. These States were Texas, Louisiana, Alaska, Oklahoma, New Mexico, Kentucky, Florida, and Wyoming. (See table 3.)

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[1] See pp. 158 and 164.

For some States severance taxes are a significant portion of their total revenue. For example, the portion is 11 percent in Louisiana and Wyoming, 10 percent in Alaska, 9.5 percent in Oklahoma, 9.3 percent in Texas, 8.6 percent in New Mexico, and 5.4 percent in Montana. (See table 4.)

The recent sharp trend in severance tax collections is continuing. Our most recent quarterly data indicated that, for the four quarters ending March 31, 1981, collections amounted to $5.5 billion which is a 57-percent increase over the $3.5 billion collected in the 12 months ending March 31, 1980. (See table 5.)

Severance taxes cover both energy-related and non-energy-related products. We estimate from various sources that nationally, approximately 90 percent of the severance taxes is derived from energy-related products. The remaining 10 percent is generated by taxes on timber and such minerals as copper, potash, sand, and gravel.

It is important to note, when using Census Bureau data, that the Census Bureau narrowly defines severance taxes as "taxes imposed on removal of natural products—that is, oil, gas, other minerals, timber, fish, et cetera—from land or water and measured by value or quantity of products removed or sold."

Some States receive substantial revenues from mineral-related properties which are not classified as severance taxes. This occurs when the taxes imposed are general sales-type taxes which cover other items in addition to natural products, either at a uniform rate or at a differential rate. West Virginia is an example of this. This State has no severance tax; yet it imposes an occupational gross income tax of 3½ percent on the proceeds from the sale of coal. This tax is classified as a general sales and gross receipts tax in the Census system. Tax revenues of these types are included in the property tax, sales tax or income tax categories in Census Bureau publications, but no separate mineral tax data are available.

I will be most pleased to answer any questions you or the subcommittee may have about the Bureau's severance tax data. In my full statement, Mr. Chairman, there are a number of tables regarding the severance tax collections.

Senator Durenberger. Thank you very much, Ms. Kallek. On the first page of your statement you indicated that only in three States—Alabama, Texas, and Virginia—do local units impose severance taxes. Do you then classify the local tax in Wyoming as a property or an ad valorem tax?

Ms. Kallek. From my understanding, I will check with Mr. Coleman, I believe that there are no local severance taxes imposed by the local units in Wyoming.

Mr. Coleman. There is a substantial property tax imposed, but that is on the local level; it is a property tax on mineral properties as well as other properties.

Senator Durenberger. Are you drawing a distinction here in terms of who is the taxing authority? In other words, whether it is a State imposed tax, or a locally imposed tax?

Ms. Kallek. No. I think the distinction is in the tax basis. If the tax is imposed on all property values, minerals may happen to be included in the valuation—the revenues would be classified as a property tax rather than a severance tax. The definition we have used for severance taxes for several decades is a very narrow definition.

Senator Durenberger. If Wyoming is imposing the same tax on coal that it imposes on all other property at the local level, you wouldn't classify it as a severance tax?

Ms. Kallek. That is right. The State may impose it at different rates than the local jurisdictions. We would not consider it a severance tax.

Senator Durenberger. If it were imposed not on an estimated value in the ground, but on a percentage of the value of the mineral as it is extracted as reflected in the sales price for example, then would it become a severance tax at this point?

Mr. Coleman. Yes, because it would be imposed distinctively on the product extracted. It would not be on the value of the minerals that lie within the ground.

Senator Durenberger. So, Wyoming's 5 or 5½ percent local tax is sort of an equivalent tax which has been used in lieu of a property tax?

Ms. Kallek. That is right, sir. In other words, our severance tax definition is narrowly defined. If you wanted to identify all taxes that were imposed on minerals, you would have to contact many sources. In many cases you would not actually be able to delineate the portion derived from taxes on minerals.

Senator Durenberger. Is it difficult? Someone must have determined the amount of property taxes on Wyoming coal. That can be done in other States. Would it be possible for you to take a look at the property tax, as opposed to the severance tax, on coal and give us some estimate by State as to what the amount might be?

Mr. Coleman. Yes. In some States I believe the tax data are such that we would be able to clearly identify it. However, in some States, I suspect that the property taxes derived from minerals would not carry a separate identification in the records.

In Wyoming we know that they do. I think it is Campbell County, Wyo., that has had a substantial increase in property taxes recently; almost all of the increase is attributable to the tax on coal property.

Ms. Kallek. In other words, we could give you an estimate, but it would be a minimum estimate. We could not determine the entire amount of property taxes on coal in all States.

Senator Durenberger. That would be helpful if we had some notion of where in the country the property tax is used to provide resources, and where the property tax on minerals is used to provide revenues for local government.

Ms. Kallek. We would be glad to assemble those data.

Senator Durenberger. Thank you.

[The data referred to follows:]

UNITED STATES DEPARTMENT OF COMMERCE
Bureau of the Census
Washington, D.C. 20233

Office of the Director

AUG [illegible] 1981

Honorable David Durenberger
Chairman, Subcommittee on
  Intergovernmental Relations
Committee on Governmental Affairs
United States Senate
Washington, DC 20510

Dear Senator Durenberger:

During testimony before your Committee by Census Bureau staff on July 16, you requested that we provide additional information regarding taxes on coal properties and operations. Accordingly, we are enclosing a report on the availability of such data in states with known coal deposits.

The findings of this study indicate that data are available in a few states for the major types of taxes relating to the coal industry. However, existing record-keeping practices in many states would make it most difficult to obtain uniform data covering all coal-related taxes for all states with active coal mining operations.

If you have any questions regarding this report, or if we can be of further assistance, please let us know.

Sincerely,

DANIEL B. LEVINE
Acting Director
Bureau of the Census

Enclosure

July 29, 1981

AN ANALYSIS OF THE AVAILABILITY OF DATA ON COAL-RELATED TAXATION

Governments Division, Bureau of the Census

A review of individual state laws, fiscal reports, coal industry materials, and telephone inquiries to state revenue officials indicates a variety of taxes on coal-related activities existing in the 36 states with known coal deposits. While our survey did not contact officials in all 36 states regarding all of the tax options in use, sufficient knowledge has been gained to indicate the difficulty of determining the total dollar amount derived from taxes on coal-related activities. The types of tax measures imposed are:

1) Severance taxes - defined by the Bureau of the Census as taxes imposed distinctively on removal of natural products from land or water and measured by value or quantity of products removed or sold.

2) Ad valorem property taxes - may be collected by state or local governments, or both.

3) Gross and net production taxes - imposed on coal production, either on gross production or net of specified expenses.

4) Sales or gross receipts taxes - imposed on gross receipts of coal mining or processing companies, or their retail sales.

5) Business license taxes - coal companies as one category of a general statute on licensing and license fees.

6) Income or franchise taxes - subjects coal companies to the same corporate net income tax laws as other major businesses.

A summary of the findings and a table showing data availability in each state follow:

1. Severance Taxes

Coal taxes classified as severance taxes in the Census Bureau format exist in 16 states. Twelve states actually had coal severance tax revenue in fiscal year 1980. These taxes vary considerably in nature, and include taxes on gross receipts from mines, net income from mines, coal mined on a per ton basis, and so forth. They are all severance taxes, however, because they are imposed on coal distinctly (that is, they are not part of a sales tax or income tax law) and are measured by value or quantity of products removed or sold.

These amounts are generally easy to obtain, even in states which tax coal production under more than one severance and related taxes. For example, New Mexico taxes coal under a severance tax and surtax (tax increase based on percentage rise in the Consumer Price Index), an oil and gas conservation tax, and a resources excise tax on the privilege of severing and processing natural resources. In addition, sale of nonfissionable natural resources other than for subsequent sale in the ordinary course of businesses or for use as an ingredient of a manufactured product is subject to the gross receipt and compensation tax.

2. Ad Valorem Property Taxes

Twenty-two of the 36 states provide for a state general property tax which is applicable to coal property. Three varieties of local taxation exist:

a. Taxation of coal property on the basis of a "gross proceeds" value of the product, plus conventional ad valorem property taxation of other coal property locally as with other taxable property. This is the situation in Montana.

b. Taxation of coal "produced" as a property tax "in lieu" of all other property taxes on coal property. The produced coal is valued on the basis of a "gross product" value and this becomes the assessed value. This is the situation in Wyoming.

c. Conventional ad valorem assessment and taxation of coal property with provision for separate taxation to respective owners of land and improvements and mineral interest components of particular holdings.

As shown on the attached table, the amount of property taxes collected from coal operations could be readily determined in only six states.

3. Gross and Net Production Taxes

This type of tax is measured at a specific rate per gross value of ore produced (determined by sales price). This is used in Kentucky. Net production taxes allow some expense to be deducted in computation of value. Idaho has such a tax but has no coal mining.

4. Sales or Gross Receipts Taxes

There are two basic problems in researching coal taxes within this Census Bureau category:

a. Gross receipts, or business and occupation taxes, are imposed in some states and apply to coal production or mining. West Virginia is the only major state in this category where taxes on the business of coal mining generated over $10 million in fiscal year 1980. Indiana also has such a tax, but no separate data are available. In Tennessee, local governments can tax coal mine production under such a tax.

b. Retail sales and use taxes exist in almost every state. It is extremely difficult to obtain measures of such taxes emanating from coal operations, however. In almost no instances could data be obtained which differentiate between coal mining and sales of coal or coal products at the wholesale and retail levels. Sales tax collections by business groups are not readily available in the type of detail needed to carry out this analysis.

The retail sale of coal is usually the only taxable transaction. This varies by state, with exemptions for coal used in domestic heating, coal for out-of-state shipment, coal for electrical generation, and the like. Retail coal sales can also exist and be taxable in states with no coal mines.

As a general rule, the amount of retail sales taxes collected on coal sales would be small. The amount collected on coal mining operations would be even smaller, since very few coal operators would sell their product retail (directly from the mine to a final user). Often these sales are tax exempt in that they are made to governments.

As for use taxes, the situation is slightly different. Use taxes can be applied against machinery used in mining, for example, as opposed to the product of the mining operation. It appears that use taxes might be significant in some states (in the millions of dollars), but more research would be required.

If there were an interest in use taxes (since they relate to coal production) as opposed to sales taxes (relating principally to retail sales of coal), it would be difficult to gather the breakdown. States with sales and use tax data by business group generally do not differentiate between the two.

5. Business License Taxes

Coal businesses are subject to the usual licensing procedures required of all businesses. The dollar amounts are small and often used to reimburse a government for special services rendered; that is, fire protection. No effort was made to collect data.

6. Income or Franchise Taxes

Four states were contacted and no data were available on taxes paid by coal business under the corporate net income tax laws.

Summary

It is apparent that with the exception of taxes paid under a specific severance tax law, it would be most difficult to get accurate data on the amount of total taxes paid by coal businesses. The attached table illustrates the difficulty of obtaining equivalent tax data from all states.

Attachment

Fiscal Year 1980 Tax Collections on Coal Operations (in thousands of dollars)

States with coal deposits	Severance taxes	General sales or gross receipts	Calculated property taxes attributable to coal properties
Alabama.............	570	-	NA
Alaska 1/...........	0	X	NA 2/
Arizona.............	X	NA 3/	NA 4/
Arkansas............	4	-	NA
California 1/.......	X	0	NA
Colorado............	11,132	-	3,195
Georgia.............	X	-	NA
Idaho 1/............	0	0	0 5/
Illinois............	X	22,000 6/	6,697 7/
Indiana.............	X	NA	NA
Iowa................	X	-	NA
Kansas..............	X	-	NA
Kentucky............	176,368	-	28
Louisiana...........	4	-	8/
Maryland............	X	-	NA
Michigan............	X	-	NA
Mississippi 1/......	X	0	NA
Missouri............	X	-	NA
Montana.............	76,055	X	17,686 9/
Nebraska............	X	-	NA
Nevada 1/...........	0	0	NA
New Mexico..........	10,507	NA	NA
North Carolina......	X		NA
North Dakota........	14,240	X	NA 10/
Ohio................	1,961	-	NA
Oklahoma............	145	-	NA
Oregon 1/...........	X	X	NA
Pennsylvania........	X	X	NA
South Dakota 1/.....	0	0	11/
Tennessee...........	1,954	-	NA
Texas...............	X	-	NA
Utah................	X	-	2,890
Virginia............	X	-	NA
Washington..........	X	-	NA
West Virginia.......	X	113,000	NA
Wyoming.............	42,943	1,699	26,579

Footnotes

R Revised
X Not applicable (no tax imposed)
NA Not available from state government records.
- Represents negligible amounts. Taxes collected, if identifiable, would be small in terms of dollar volume. In most states, specific data were not available from existing state sources on sales and use tax collections by business group.

1/ Coal deposits exist, but there are no operating mines at the current time (Alaska, California, Idaho, Mississippi, Nevada, Oregon, South Dakota).

2/ Alaska - Although substantial coal deposits exist, they are for the most part on federal lands outside the jurisdiction of any taxing unit. Two boroughs have inactive taxable coal leases; assessed value for such leases is small.

3/ Arizona - Only one operating coal mine is in existence, but data cannot be released because of confidentiality laws. The state taxes coal production under the general sales tax law at 2.5 percent of value.

4/ Arizona - Coal property is located only on Indian reservations, and is therefore exempt from ad valorem taxes. Some items, however are taxable (equipment, vehicles, etc.) as property.

5/ Idaho - Although small coal deposits exist and are taxable, they have not been assessed for property taxation.

6/ Illinois - The amount is an estimate from the State Department of Revenue.

7/ Illinois - Amount is based on coal rights separately assessed; excludes any coal property assessed as part of land.

8/ Louisiana - No ad valorem property taxes assessed on coal at this time.

9/ Montana - Ad valorem tax, "class 2" among Montana's classifications, is a personal property tax, state assessed and collected. The measure of tax is "gross proceeds" of products sold. The taxable "gross proceeds" value is the assessed value and is calculated as follows: (a) For coal mines using the strip-mining method, taxable "gross proceeds" value equals 45 percent of annual gross proceeds; (b) For underground coal mines, taxable "gross proceeds" value equals 33 1/3 percent of annual gross proceeds. Currently Montana has no underground mines.

In addition, each local assessor has the responsibility to assess all real and personal property of mining companies, other than coal.

10/ North Dakota - Statutory authority exists for local governments to assess and collect ad valorem taxes on coal. County auditors have thus far ignored this area of taxation. No known tax collections.

11/ South Dakota - Statutory authorization exists but there are no assessments at this time.

Senator DURENBERGER. We also need, for the record, the rate of the local severance tax in Alabama, Texas, and Virginia. If we could have that, it would be helpful.

[The information referred to follows:]

Local government severance taxes on coal

There are just two states identified to date which allow a local government to levy a coal severance tax. These are:

Alabama:	*1980 collections*
De Kalb County—50¢ per ton of coal	$114,381
Jackson County—50¢ per ton of coal	197,533

Virginia: Any city or county levy up to 1 percent severance tax on gas or coal for roads improvement involved in transportation of coal.

Dickenson County	1,300,000
Lee County	88,000
Wise County	2,800,000

NOTE.—There are non-energy related local government severance taxes on stone and gravel authorized in Tennessee and Minnesota. The State of Texas allows the City of Post, Texas to collect a 2.3 cents severance tax per barrel of oil.

Senator DURENBERGER. You indicated in your statement that we had 28 States with a severance tax prior to 1974. After that we added four more. What were the four new ones that got added?

Ms. KALLEK. I am sorry. I don't have that in my record. We can supply it.

Mr. COLEMAN. We know two of them—Missouri and North Carolina. But the other two I cannot identify at this moment.

Senator DURENBERGER. Fine, if you could supply that information it would be helpful.

[The information referred to follows:]

NEW STATE SEVERENCE TAXES

Two states enacted energy related severance taxes in the last decade: Tennessee—coal tax—effective April 19, 1973; South Dakota—mineral and mineral products—effective July 1, 1975.

Two states enacted timber severance taxes: Washington—timber tax—effective October 1, 1972; North Carolina—forest products tax—effective July 1, 1977.

The State of Missouri has a forest cropland tax that was reclassified from an occupation and business license tax to a severance tax for fiscal year 1978.

Senator DURENBERGER. Yesterday, former Congressman Maguire made the point that the real explosion in severance tax revenue is likely to come after 1985. Has the Census Bureau made any projections of likely severance tax revenues through 1990?

Ms. KALLEK. We do not make projections, Mr. Chairman.

Senator DURENBERGER. You indicated that some States have an occupational or other general sales-type tax which has the effect of a severance tax. However, the revenues from these taxes are included in the figures on property tax, sales tax or income tax categories. I know you don't keep specific records on some of these, but do you have any kind of a feel for the magnitude of the revenues from other taxes and severance taxes?

Mr. COLEMAN. No, sir. I don't.

Senator DURENBERGER. Thank you very much. We appreciate your testimony.

Ms. KALLEK. Thank you, sir.

[Ms. Kallek's prepared statement, with attachments, follows:]

Statement of
Shirley Kallek
Associate Director for Economic Fields
Bureau of the Census
Department of Commerce
before the
Senate Intergovernmental Relations Subcommittee
on the Commerce Clause and Severance Taxes
July 15, 1981

Mr. Chairman, I am pleased to have the opportunity to appear before this Committee to describe the Bureau's program on State and local governments tax collections. I am accompanied by Mr. John Coleman, Acting Chief of the Bureau's Governments Division.

The Census Bureau has an extensive quarterly and annual program on state and local governments revenues and tax collections in addition to its quinquennial census of state and local governments. According to our 1977 Census of Governments, there are 80,000 local governmental units including counties, municipalities, townships, schools and special districts in the United States, of which 68,000 units are authorized to impose taxes. Since only a few local units in three states, Alabama, Texas, and Virginia impose severance taxes, data for this category are not collected separately at the local level.

Data on severance tax collections collected by states are obtained annually and quarterly. Currently, there are 33 states imposing such taxes. The number of states was fairly constant at 28 or 29 between 1965 and 1974 but since then 4 more states have added this provision. As can be seen in Table 1 and Chart 1, total severance tax revenue rose slowly from 1965 to 1973, from $503 million in 1964 to $850 million in 1973, and to $1,255 million in 1974 and accounted for less than 2 percent of total state tax revenues. Since 1975 there has been a much sharper increase in revenues from the severance tax with a 44 percent increase between fiscal years 1979 and 1980, from $2.9 billion to $4.2 billion.

Table 2 shows that severance tax revenue from 1975-1979 amounted to between 3.7 and 4.1 percent of total taxes for states using that revenue source, and in 1980 the percentage rose sharply to 4.9. For the same states, severance taxes as a percent of total state revenue (including revenues other than taxes) have been a consistent 2 percent from 1975-1979; however, final revenue data are not yet available for 1980.

Of the 33 states shown in Table 3 imposing severance taxes in 1980, 8 states accounted for 86.6 percent of the national total of $4.2 billion. These 8 states are:

(Millions of dollars)

Texas	1,525	New Mexico	214
Louisiana	525	Kentucky	177
Alaska	506	Florida	121
Oklahoma	436	Wyoming	106

For some of these states severance taxes are a significant portion of their total revenue, as can be seen in Table 4. This shows 11.1 percent in Louisiana and Wyoming, 10.2 percent in Alaska, 9.5 percent in Oklahoma, 9.3 percent in Texas, 8.6 percent in New Mexico, and 5.4 percent in Montana.

Table 5 presents quarterly data on state severance tax collections for the nine most recent quarters. For the 12 months ending March 31, 1981, collections amounted to $5.5 billion, a 57 percent increase over the $3.5 billion collected in the 12 months ending March 31, 1980. The recent sharp trend in severance tax collections is continuing.

Severance taxes cover both energy-related and nonenergy-related products. Through review of documents available at the Bureau and telephone inquiries to state tax departments, we estimate that nationally approximately 90 percent of severance taxes is derived from energy-related products. The remaining 10 percent is generated by taxes on timber and such minerals as copper, potash, sand, and gravel.

The annual report entitled State Government Tax Collections published by the Census Bureau shows the collections obtained from the various tax bases available in each state. Nationally in 1980, state governments obtained about 49 percent of their tax revenues from sales and gross receipts taxes, 27 percent from individual income taxes, 10 percent from corporate income taxes, 6 percent from license taxes, 3 percent from severance taxes and 5 percent from all other taxes.

It is important to note that the Census Bureau defines severance taxes as: Taxes imposed distinctively on removal of natural products - e.g., oil, gas, other minerals, timber, fish, etc. - from land or water and measured by value or quantity of products removed or sold.

Some states receive substantial revenues from mineral-related properties which are not classified as severance taxes. This occurs when the taxes imposed are general sales type taxes which cover other items in addition to natural products, either at a uniform rate or at a differential rate. West Virginia is an example. This state has no severance tax. Yet it imposes an occupational gross income tax of 3.5 percent on the proceeds from sale of coal. This tax is classified as a general sales and gross receipts tax in the Census system. Tax revenues of these types are included in the property tax, sales tax, or income tax categories in Census Bureau publications but no separate data are available.

I would be pleased to answer any questions you or the Committee may have about the Bureau's severance tax data.

Table 1

State Severance Taxes, Total State Taxes and Total State Revenue
1965-1980

(Millions of dollars)

Year	Number of states using tax	Total state severance taxes	U.S. total state taxes	U.S. total state revenue	Severance taxes as a percent of — U.S. total state taxes	Severance taxes as a percent of — U.S. total state revenue
1965	29	503.4	26,126.1	48,826.9	1.9	1.0
1966	29	545.3	29,379.8	55,246.1	1.9	1.0
1967	29	577.1	31,926.1	61,081.8	1.8	0.9
1968	29	618.4	36,400.2	68,459.9	1.7	0.9
1969	28	630.4	41,930.7	77,584.3	1.5	0.8
1970	28	685.9	47,962.0	88,939.3	1.4	0.8
1971	28	733.0	51,541.2	97,232.9	1.4	0.8
1972	28	757.6	59,870.4	112,309.4	1.3	0.7
1973	29	850.4	68,069.3	129,807.8	1.2	0.7
1974	29	1,255.0	74,206.9	140,751.1	1.7	0.9
1975	30	1,741.2	80,154.9	154,632.5	2.2	1.1
1976	31	2,028.7	89,255.5	185,213.2	2.3	1.1
1977	31	2,168.2	101,084.6	204,474.9	2.1	1.1
1978	32	2,494.3	113,260.9	225,011.0	2.2	1.1
1979	33	2,893.1	124,962.9	247,059.0	2.3	1.2
1980	33	4,167.4[1]	136,913.3	NA	3.0	NA

NA - Not available.

SOURCES: State Government Finances, annual report by the Bureau of the Census, for all data through 1979 and State Government Tax Collections in 1980 for 1980 data.

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[1] These data are collection amounts and are not revenue.

Table 2

Severance Taxes, Total Taxes and Total Revenue of All States Using Severance Taxes: 1975 to 1980

(Millions of dollars)

Years	Number of states using tax	Total state severance taxes	Total state taxes	Total state revenue	Severance taxes as a percent of --	
					Total state taxes	Total state revenue
1975	30	1,741.2	44,523.8	87,169.5	3.9	2.0
1976	31	2,028.7	49,931.2	103,881.6	4.1	2.0
1977	31	2,168.2	57,161.5	116,365.4	3.8	1.9
1978	32	2,494.3	67,319.7	133,770.0	3.7	1.9
1979	33	2,893.1	77,525.2	153,342.6	3.7	1.9
1980	33	4,167.4	85,242.5	NA	4.9	NA

NA - Not available.

SOURCES: State Government Finances, annual report by the Bureau of the Census, for all data for 1975 to 1979. State Government Tax Collections in 1980 for 1980.

Table 3

State Government Severance Tax Revenue: Fiscal Years 1976 - 1980

(Thousands of dollars)

	1976	1977	1978	1979	1980
UNITED STATES..	2,028,690	2,168,198	2,494,328	2,893,148	4,167,399
Alabama..........	11,570	13.757	17,056	22,281	32.410
Alaska...........	27,978	23,758	107,715	173,685	506,469
Arkansas.........	8,870	10,495	12,391	12,502	18,051
California.......	2,334	1,530	31,235	48.093	25,954
Colorado.........	4,375	2,320	1,838	19,803	31.121
Florida..........	47,377	47,076	94,804	91,902	121,254
Idaho............	394	203	273	552	1,905
Indiana..........	508	580	649	673	1,582
Kansas...........	785	816	841	1.097	1.100
Kentucky.........	91,496	113,005	128,160	154,017	177,244
Louisiana........	558,495	495,498	476,829	511,589	525,297
Michigan.........	7,065	9,574	11,718	13,724	43,525
Minnesota........	58,171	59,718	61,945	71,263	83.459
Mississippi......	23,601	25,358	27,559	32,922	52,514
Missouri.........	-	-	36	45	46
Montana..........	31,344	43,543	44,667	53,919	94,636
Nebraska.........	1.113	1,131	1,243	1,516	2,948
Nevada...........	148	105	129	54	23
New Hampshire....	103	144	174	207	311
New Mexico.......	87,485	102,783	145,826	159,431	213,643
North Carolina...	-	-	-	1,013	1,292
North Dakota.....	12,594	15,418	18,619	25,503	43,927
Ohio.............	3,930	3,918	3.800	4,582	4,596
Oklahoma.........	151,316	191,351	230,368	280,982	436,098
Oregon...........	3,458	3,680	4,117	47,625	50.592
South Dakota.....	310	536	872	884	2,423
Tennessee........	1,818	2.052	2,128	2,155	2.204
Texas............	800,693	907,281	959.686	1,025,550	1,525,118
Utah.............	11,723	8,931	8,926	8,993	10.584
Virginia.........	707	705	813	1,003	1,012
Washington.......	37,477	35,265	33.288	37,802	49,924
Wisconsin........	478	698	602	362	437
Wyoming..........	40,974	46,969	66.021	87,419	105,700

SOURCE: State Government Finances, annual report by Bureau of the Census, for all data through 1979 and State Government Tax Collections in 1980 for 1980 data.

- Represents zero.

Table 4

State Severance Tax Revenue as Percentage of Total Taxes and Total Revenue, by State
Selected Years 1965 - 1980

State	Severance taxes as percent of total taxes					Severance taxes as percent of total revenue[1]			
	1965	1970	1975	1979	1980[1]	1965	1970	1975	1979
United States	1.9	1.4	2.2	2.3	3.0	1.0	0.8	1.1	1.2
labama	0.4	0.3	1.0	1.3	1.7	0.2	0.2	0.5	0.6
laska	7.1	12.5	14.5	21.3	35.2	1.6	0.9	4.2	10.2
rkansas	2.1	1.2	1.1	1.3	1.6	1.2	0.7	0.6	0.6
alifornia	(X)	(X)	(X)	0.3	0.1	(X)	(X)	(X)	0.2
olorado	0.5	0.2	0.3	1.4	2.1	0.2	0.1	0.1	0.6
lorida	(X)	(X)	1.1	2.1	2.5	(X)	(X)	0.6	1.3
daho	0.2	0.2	0.2	0.1	0.4	0.1	0.1	0.1	0.1
ndiana	(X)	(X)	(X)	(X)	0.1	(X)	(X)	(X)	(X)
ansas	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
entucky	0.1	(X)	7.7	7.4	8.3	(X)	(X)	4.1	4.0
ouisiana	30.8	29.9	35.9	22.8	21.9	15.9	15.1	19.0	11.1
ichigan	0.1	(X)	0.1	0.2	0.7	(X)	(X)	0.1	0.1
innesota	3.3	1.9	1.8	2.3	2.6	1.9	1.1	1.0	1.3
ississippi	4.5	2.9	2.7	2.8	4.2	2.5	1.5	1.3	1.3
issouri	(X)	-	-	(X)	(X)	(X)	-	-	(X)
ontana	3.6	3.7	6.3	13.5	21.7	1.3	1.4	2.4	5.4
ebraska	0.9	0.3	0.2	0.2	0.4	0.4	0.2	0.1	0.1
evada	(X)	(X)	0.1	(X)	(X)	(X)	(X)	(X)	(X)
ew Hampshire	0.1	0.1	0.1	0.1	0.1	(X)	(X)	(X)	(X)
ew Mexico	14.7	12.9	13.8	18.9	23.1	7.1	5.9	6.6	8.6
orth Carolina	-	-	-	(X)	(X)	-	-	-	(X)
orth Dakota	4.1	2.6	2.6	7.9	11.6	1.6	1.1	1.2	3.1
hio	-	-	0.1	0.1	0.1	-	-	0.1	(X)
klahoma	10.8	10.1	14.5	18.5	24.6	5.7	4.7	7.3	9.5
regon	0.3	0.4	0.4	3.4	3.5	0.1	0.2	0.2	1.4
outh Dakota	0.4	(X)	-	0.4	0.9	0.2	(X)	-	0.1
ennessee	-	-	0.1	0.1	0.1	-	-	0.1	0.1
exas	17.0	13.8	18.3	17.9	22.6	9.4	7.5	9.9	9.3
tah	2.1	1.7	1.6	1.3	1.3	1.0	0.8	0.7	0.6
irginia	0.1	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
ashington	-	-	1.5	1.4	1.7	-	-	0.7	0.7
isconsin	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
yoming	0.2	5.1	11.8	25.5	27.2	(X)	1.9	4.7	11.1

- Represents zero. X Rounds to zero.

1980 data calculated from State Government Tax Collections in 1980. Total revenue data for 1980 not yet available.

URCE: Calculated from statistics in State Government Finances, annual report by the Bureau of the Census.

Table 5

State Government Severance Tax Collections for 9 Quarters. First Quarter Calendar 1979 Through First Quarter Calendar 1981 (Thousands of dollars)[1]

	Calendar Year 1979			
	Jan. - March	April - June	July - Sept.	Oct. - Dec.
UNITED STATES	723,917	704,656	836,809	938,928
labama	5,627	5,442	5,852	5,155
laska	42,991	58,433	48,405	118,149
rkansas	2,531	3,180	3,628	4,077
alifornia	11,571	1,669	6,392	10,087
olorado	1,662	8,190	5,887	5,388
lorida	21,589	33,390	24,372	24,564
daho	33	202	228	186
ndiana	165	146	332	331
ansas	297	331	183	189
entucky	44,460	42,931	39,523	41,859
ouisiana	112,343	117,712	126,394	122,739
ichigan	2,754	4,305	3,438	3,439
innesota	42,828	21,802	1,471	1,631
ississippi	8,664	8,837	10,301	12,230
issouri	9	9	12	12
ontana	14,584	12,657	NA	22,287
ebraska	384	443	445	746
evada	51	1	NA	13
ew Hampshire	173	27	16	15
ew Mexico	44,743	38,531	42,471	49,858
orth Carolina	NA	NA	250	299
orth Dakota	6,665	6,833	7,692	9,443
hio	1,148	997	1,112	1,176
klahoma	74,422	75,573	85,003	98,876
regon	12,194	11,606	13,659	13,732
outh Dakota	148	275	300	601
ennessee	438	503	513	511
exas	256,253	231,809	291,632	374,604
tah	122	8,529	356	231
irginia	250	343	147	292
ashington	9,834	9,319	11,700	12,353
isconsin	76	91	22	125
yoming	4,908	540	105,073	3,730

URCE: Unpublished data, Bureau of the Census

- Represents zero. NA - Not available.

[1] Collections in this table differ at times from revenue reported in other tables due to several factors, such as refunds to taxpayers, revisions in data reported by states, amounts in litigation, etc.

TABLE 5
(Cont'd)

	Calendar Year 1980				Calendar year 1981
	Jan. - Mar.	Apr. - June	July - Sept.	Oct. - Dec.	Jan. - Mar.
UNITED STATES	1,010,933	1,271,072	1,367,834	1,296,657	1,559,109
labama	7,120	7,893	12,242	11,580	16,223
laska	75,383	264,531	239,206	250,661	207,921
rkansas	4,897	5,647	5,118	5,148	6,116
alifornia	4,221	1,718	4,514	6,919	3,700
olorado	1,752	12,438	6,956	7,233	1,923
lorida	25,629	46,689	14,412	34,017	48,959
daho	27	1,464	411	627	91
ndiana	482	438	430	438	476
ansas	242	209	253	219	267
entucky	47,871	47,991	45,156	49,587	54,728
ouisiana	131,662	143,764	159,345	169,547	211,018
ichigan	8,947	13,976	17,163	14,592	22,446
innesota	58,474	21,880	1,524	882	48,913
ississippi	12,817	17,167	18,395	16,476	23,344
issouri	12	12	9	12	12
ontana	25,694	26,406	19,963	22,714	26,950
ebraska	783	974	946	951	366
evada	7	3	-	X	X
ew Hampshire	248	32	5	7	21
ew Mexico	56,633	64,684	65,251	79,740	89,026
orth Carolina	363	307	383	310	344
orth Dakota	11,743	15,050	16,896	18,091	19,376
hio	1,117	1,015	1,038	1,071	1,079
klahoma	124,179	129,248	133,022	137,533	159,106
regon	13,433	9,768	15,211	12,942	17,394
outh Dakota	544	1,030	1,064	1,443	2,062
ennessee	459	471	494	539	498
exas	382,776	412,861	435,461	437,649	583,082
tah	179	9,818	462	276	448
irginia	365	208	178	275	380
ashington	12,624	13,247	15,670	14,718	11,863
isconsin	133	91	124	51	158
yoming	117	42	136,532	409	819

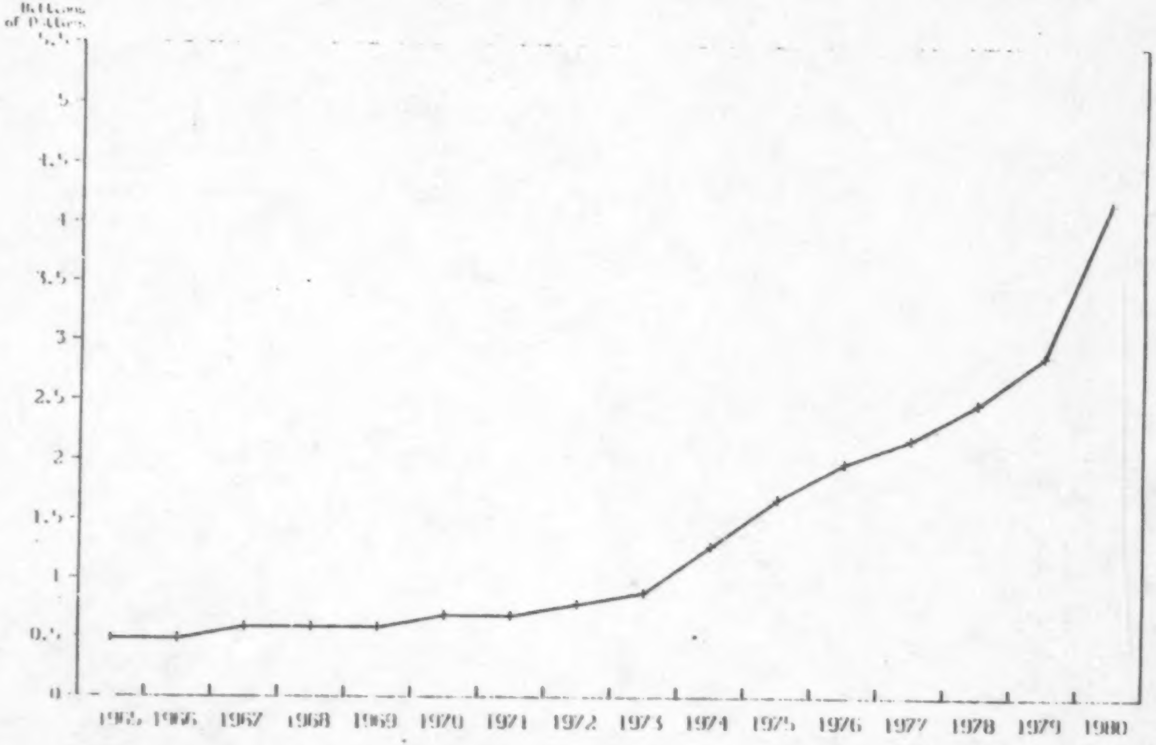
SOURCE: Unpublished data, Bureau of the Census

- Represents zero

X Rounds to zero.

CHART 1

State Government Severance Tax Collections: 1965-1980



SOURCE: Bureau of the Census.

Senator **Durenberger.** In order to compile a complete record of the present use of severance taxes, I recently requested the Bureau of Mines to update their circular entitled "Taxation, Mining, and the Severance Tax." This is a sizable task and the Bureau is still in the process of completing it. I will hold the hearing record open so that the circular can be enclosed at the appropriate place.[1]

Next we will have a panel of four witnesses—Congressman James Oberstar from the 8th District of Minnesota, Mayor Morris Lanning from Moorhead, Mayor Ralph Possehl from Breckenridge, and Dick Kirkham with the Minnesota Municipal Utilities Association.

I want to thank the four of you for coming here today. I want to say, for the record, that it is not the purpose of this panel to bring the chairman's home State into the batter's box for public relations purposes. It is because those of you who are part of this panel talk to the fiscal disparities issue better than anybody else in the country. Fiscal disparities is the subject that brings us here, not just the issue of the severance tax. Talking about the severance tax in that context, it is clear that we in Minnesota live as close as any total energy-consuming State to energy-producing States. We are the ones who first feel the effects of what is starting to happen all over this country. So I appreciate your coming.

Jim, you have been in this business for a long time. I read a lot about your forays into places like Montana and other Western States to talk about this issue. I compliment you for doing that and I very much appreciate your being here today.

TESTIMONY OF HON. JAMES OBERSTAR, REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA; MORRIS LANNING, MAYOR OF MOORHEAD, MINN.; RALPH POSSEHL, MAYOR OF BRECKENRIDGE, MINN.; AND RICHARD KIRKHAM, EXECUTIVE DIRECTOR, MINNESOTA MUNICIPAL UTILITIES ASSOCIATION

Representative **Oberstar.** Thank you very much, Mr. Chairman. Permit me to return the compliment and say that no one may construe this to be a part of a public relations effort. You have been very sincerely concerned about the issue of severance tax impact on our State of Minnesota and on other energy importing States. I commend you for holding these hearings, for the interest that you have demonstrated and for the effort that you have made. We appreciate it.

These hearings are important to the people of Minnesota, Mr. Chairman. However, the impact of the hearings will be felt far beyond the borders of our State. The impact has significance for people in all energy importing States who will pay billions of dollars to those States which, by the simple accident of nature, happen to have enormous supplies of nonrenewable sources of energy.

I know that Mayor Don Fraser of Minneapolis would very much have liked to have been with us here today, not only because of his concern for his city of Minneapolis, but as chairman of the National

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[1] See p. 426.

Coal Consumers Alliance. He wanted to participate and has submitted a statement for the hearing record.[1]

The Supreme Court decision in the case of *Commonwealth Edison Co.* v. *Montana*, while confirming the right asserted by a State to impose severance taxes, recognnized the authority of the Congress to establish reasonable limits on severance taxes. I would have preferred to have had a more favorable outcome on the merits of the case, but there is a certain wisdom in the Court's decision that the Congress—a legislative body—and not the Court, should determine which severance taxes are excessive. Those of us who joined the Court case as amicus curiae did not get the decision we wanted. We did get, however, the clear statement that the Congress has the authority to determine reasonable standards for energy severance taxes.

In its opinion, the Court stated,

> The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution.

Justice White went even further by stating,

> Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. . . . The Constitutional authority and machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress, and surely Montana and other similarly situated States do not have the political power to impose their will on the rest of the country.

The latter may be a bit of an overstatement. The Justice, never having served in the Senate, and not fully appreciative of the filibuster, may be to optimistic. It is clearly a correct statement of the constitutional authority that Congress has the power to protect interstate commerce from intolerable and undesirable burdens. Those of us in Minnesota who pay more of the Montana severance tax than do the people in any other State, certainly feel that that tax is "intolerable and undesirable."

I have joined in sponsoring H.R. 1313, which is similar to legislation introduced in the 96th Congress to put a 12½ percent limitation on the amount of coal severance tax that a State can impose. While that is important in Minnesota, it affects other States as well. There are 26 States, in fact, that consume coal produced in Montana and Wyoming—the rich, low-sulfur coal area of the West. While Montana's tax is high, Mr. Chairman, it is peanuts compared to the taxes collected on oil and gas by other States of the country. However, those peanuts are growing and, by the year 2000, they will total somewhere in the neighborhood of $20 billion for the State of Montana alone.

I am also here speaking in behalf of the Northeast-Midwest Congressional Coalition. This is a group of Northeastern, Midwestern, Middle Atlantic States—18 States in all—200 plus Members of Congress who are concerned about regional disparities. Our concerns include the effect of the severance taxes on our economies which are dependent on Western coal for clean air and electricity generation.

The Northeast-Midwest Institute conducted a study of severance taxes.[2] It estimated that in the decade 1981–90, oil severance tax revenues for Texas will total $35 billion; for Louisiana, $45 billion; and for Alaska, $29 billion. In 1979, 64 percent of the Texas oil tax, 79 percent of the Louisiana tax, and 85 percent of the Alaska tax were exported.

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[1] See p. 459.
[2] See p. 462.

The issue is not whether a State can impose a reasonable severance tax to reflect the economic and environmental impact of the development of that energy resource. We don't quarrel with the principle. We do quarrel about the extent of the tax and the reasonableness of it. We realize that the States in the Western area with low population and sensitive environmental considerations have to make certain preparations for population explosion, transportation access, and environmental impact. I submit, however—as I suggested to Governor Herschler of Wyoming when I debated him on the severance tax issue a few weeks ago—that S. 2332 of the 96th Congress, acted on by this body with the chairman's support, provided inland energy impact assistance.

In the Outer Continental Shelf Act the Congress has wisely provided assistance to the States who will suffer severance impacts from the development of oil and gas off their coastal shores, but on U.S. Outer Continental Shelf lands. We have provided generous assistance to those States to accommodate that impact. We ought to do the same for the inland States. We ought not let them take it out of the hide of the States that are literally captive States to those Western coal-producing areas.

The framers of the Constitution intended that the Congress should use the movement of commerce among the States as a restraint against State taxation of that interstate commerce. James Madison believed that the framers of the Constitution had included the commerce clause in order to prevent what he called "unbridled State taxation of the commerce of other States."

Madison wrote, in his records of the Constitution, that the commerce clause grew out of the abuse of the power of the importing States in taxing the nonimporting. The commerce clause was intended as a preventive provision against injustice among the States. It was the maritime States that heavily taxed the goods which were so desperately needed by the inland States. Just as the original revolt against England was the result of overtaxation by a body in which we had no representation, the inland States considered the taxation by the maritime States unfair because they had no representation in the process by which that taxation was imposed.

We have the same situation prevailing today. The Western States are imposing excessive taxes on Minnesota and the other States, which have no say in how those tax laws will be written or the use to which those taxes will be put. We are, in effect, paying for a wide range of government services, most of which have nothing to do with the impact of coal mining. Twelve percent of Montana's severance tax goes to ease the impact of energy development. Eighty-eight percent of it is distributed—50 percent in a trust fund, 6 percent in an educational fund, 6 or 7 percent to help general revenues, and the rest is distributed among the current ongoing general needs of the State. Only 12 percent is set aside to deal with mining impact.

I suggest that there are four major Federal laws that provide royalties, revenues and income to those Western States to help them with their energy impact-related developments. These are funds which could rightfully come into the Treasury of the United States. For example, under the Mineral Leasing Act, 50 percent of the revenue goes back to the State of origin. The Congress has generously decided to share half with those States, but it is not enough for them.

Wyoming gets $126 million in payments in lieu of taxes, mineral leasing royalties, and other Federal payments. Remember that 60 percent—let me correct that—75 percent of Montana and Wyoming coal comes from Federal lands. That coal belongs to all Americans, not just the people of those States.

As legislators serving in the U.S. Congress, we have to be concerned about all States, including those whose citizens are providing the billions of dollars in tax revenues to the energy-producing States. We have to have uniform national policies that will not enrich some at the expense of others, particularly when such enormous amounts of that tax are exported, 90 percent of Montana's coal is exported, and just about the same percentage of Wyoming's coal is exported.

Failure to address the regional inequities will result in allowing the creation in the United States of a kind of United American Emirates of the West. Felix Rohatyn, who has done such a brilliant job of managing urban finances, said that continuation of current Federal energy policies and State energy severance taxation will leave half the country nearly bankrupt—many of its major cities pools of unemployment and unrest, and the other half swimming in oil, industry, and wealth. This is not the stuff of a stable democracy. It is not the stuff of a "Union of States."

He states the case perhaps a little more bluntly and in more contemporary terms than did Madison, but he states it effectively. What has made our country great is the cooperation, not the competition, among States—the free and unencumbered movement of commerce among the States. Limitation on severance taxes will enhance that free movement of commerce.

Thank you, Mr. Chairman.

Senator **Durenberger**. I appreciate your going back and giving us a little bit of a history lesson. A lot of us who invoke States' rights forget that, when we were a Confederation rather than a United States of America under a Constitution, we did have these kinds of problems. We try to learn something from that kind of a problem. We went through it once. Fortunately we went through it 205 years ago—from 215 to 205 years ago. As you pointed out, our forefathers and foremothers, in their wisdom, learned something from that process. They put together a beautiful Federal system that changes from time to time. It looks a little bit different. It has a Supreme Court that interprets it and a Congress to give some flexibility to it.

We are running the risk of going back 215 years and making some of those same mistakes all over again. The Supreme Court—putting a good face on that *Montana* case—probably said to the Congress, "You have an opportunity under this constitutional system to redress a growing problem before it gets out of hand."

I appreciate your recalling that for all of us because it puts it in an appropriate perspective.

I want to ask you about—I understand you have to leave at 10 o'clock?

Representative **Oberstar**. Yes, the House meets at 10 o'clock today.

Senator **Durenberger**. Normally, I go through the panel and then ask questions. I understood you would have to leave, so I will ask you questions first. Then the rest of the panel can speak, and I will ask them questions together.

I would like to know about your bill which passed out of committee last year and went to the floor. What is happening to H.R. 1313 [1] this year?

Representative **Oberstar**. It is in committee. We expect to have hearings on it this year. We have about 70 cosponsors. We are looking forward to action on it during this Congress. All of us had been waiting for the Court decision.

Senator **Durenberger**. How are your colleagues reacting to the Supreme Court's decision in *Commonwealth Edison Co.* v. *Montana* case?

Representative **Oberstar**. We went into it realizing that our perspectives differed from that of the plaintiffs in the case. We and the Members of Congress joined to support those who are contesting the tax. We did not feel that a severance tax was unconstitutional. Our quarrel is with the level of the tax. We felt that the constitutional principle was important and that we needed to have someone make the argument from the standpoint of commerce.

When the decision came down, we felt very encouraged by what Justice White said. He reenforced our position that, where a tax is unreasonable, the Congress should go ahead and do something about it. Now the burden clearly is on the Congress.

Senator **Durenberger**. The concern that both of us have—I am sure you see it on your side—is that there are, in fact, some Western State Senators and Governors who are not going to appear here today because they think they will be able to look at this thing in a better light in a couple of months.

There has been a great deal of interest in this issue, because a lot of States who haven't had it too good for a long time are now rolling in wealth or the prospects of wealth. To have some of us big energy consumers, exploiters of wealth, and so forth, come and try to tie the noose around their necks is offensive to them.

The reason why all of this is being put in the context of federalism, intergovernmental relations, and fiscal disparities—why we are dealing with it in the kind of panel we have here today—is basically to appeal to the sense of public service which brings all of those people to office. We are trying to find appropriate roles for the States in this Federal system.

You were right the first time when you were talking about the Montana coal—when you were fetching around at the higher number. The fact of the matter is that 75 percent is in Federal land in Montana. We have been relatively generous, I guess. We took them up from 37½ percent to 50 percent. But as you pointed out, we have done lots of other things to offset the costs of extracting, processing, and transporting in those States.

Morris Lanning will tell you nobody has done anything about the 200 car trains which go through Moorhead and cut his city in half.

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[1] See p. 488 for text of H.R. 1313.

We have, at the Federal level, provided a variety of programs to offset some of these costs in these States.

The States themselves have wisely internalized a lot of these costs. You can't measure them straight out in dollars because, by regulation, they have said that the coal companies and the mining companies must do this. They must do that.

This whole issue of what is the burden on the State, and the return to the State, is one that needs to be addressed. John Melcher was here yesterday. He said what both of us have heard—simply, "Hey, you Minnesotans, who have been ripping off the country for nigh on to 90 to 100 years with your iron ore taxes and now your taconite taxes, you have got some kind of a heritage fund. You don't call it that, but you put some of that money away. So what are you doing calling the kettle black?" How do you respond to that when you get out West? I want to qualify this by saying that this Congressman lives on top of all of that iron ore and on top of all of that taconite. I am going to ask you shortly about all the other things you live on top of—like copper, coal, and cobalt.

Representative **Oberstar**. First of all, there is a distinction between the tax on iron ore and the tax on coal. The coal severance tax is on a commodity that goes to a very limited number of States which are energy poor or, as in our case, have no energy resources at all except for wood, which is available in most of the country.

The tax on iron ore is a much older tax, a much lower percentage tax—7.6 percent. It is distributed throughout the whole national economy. It was not targeted at a few States. It was a severance tax that has existed from the time kings discovered they could make money off of an occupation or a richness in the ground.

Third, in the case of Montana, the coal companies already pay the cost of reclamation in the price of coal. We are paying for it twice, in the cost of the coal and in the tax that the State of Montana imposes on that coal.

The final point that I would make to our Western colleagues when they make the argument that Minnesota has a sales tax on electricity which is more than the severance tax, I would point out that Minnesota also has the wisdom to lift that tax on electricity during the winter months.

Senator **Durenberger**. Very few people realize that the State we represent is the largest nonfuel mineral State in the whole country. If they think they have seen a lot of our ore, they really ain't seen nothing yet. Wait until the time they need the copper, the cobalt, and the variety of other things that are in—all of which I guess—are in your district.

I don't know if you hear some of the things that I do in terms of the pressures within the State which is cutting its spending but raising its taxes and still coming up short every year. Pressure is being applied for the State to get at the business of extracting that mineral.

What would be your expectation, if we move in the direction of extracting some of these new minerals, as to what might be State policy in Minnesota with regard to severance taxes on these new minerals?

Representative **Oberstar**. My expectation is that a precedence is also in existence on iron ore. Surely no higher level or greater rate of taxation would apply to copper-nickel than does apply to iron or taconite. Taconite is a different tax matter than iron ore, a different tax structure.

There is no different reason for the kind of tax that Montana has imposed on coal than for the kind of tax Minnesota could impose on copper-nickel. The companies will be required, under Minnesota law, to take the environmental protection measures necessary to prevent the escape of harmful materials into the environment. That cost will be included in the cost of the final product. I do not foresee Minnesota attempting to extort the rest of the country simply because it has the second largest source of nickel in the United States.

Senator DURENBERGER. One of the reasons for that is basically economic. Right now I imagine a lot of our constituents would love to see us react to the high cost of energy by increasing taxes on taconite. You and I both know that there is a world market out there for this ore which is a lot larger than the market for steel right now. We also know that domestic prices are generally higher than import prices. There is, in effect, a lid on what we can do with the resources in our State which others might need.

Representative OBERSTAR. Exactly, Mr. Chairman. Iron ore is the second most abundant material on the Earth; only exceeded by silicate, plain sand. There are billions of tons of readily accessible iron ore from other countries, competitive with that of Minnesota.

As I said earlier, we are totally at the mercy of the low-sulfur coal Western States because we don't have any of our own.

Senator DURENBERGER. One final question. In addition to the coal which we import to produce electricity, we also in some parts of Minnesota import electricity, principally from North Dakota's powerplants.

I understand that M.P. & L. has a plant in North Dakota and, of course, UPA and CPA have plants out there. Have you or the Northeast-Midwest Coalition looked into how severance taxes are exported across State lines with electricity? I ask that because yesterday we had an economist here who indicated to us that one of the major differences between North Dakota and Montana was that Montana was successful in exporting practically all—90 percent plus—with its 30-percent severance tax, whereas in North Dakota much of the coal, and I presume the oil, is consumed and refined in North Dakota.

That may be true with regard to the mineral itself, but as a practical matter North Dakota has just been smart enough to generate—or circumstances have brought this about—the power there and then export the power. I am curious to know whether we have looked at how the taxes in North Dakota have been exported to Minnesota and other States by electricity. Has the Northeast-Midwest Coalition looked at that?

Representative OBERSTAR. We do not have information on that. We have established a task group which is charged with looking at taxes being exported to other States. I hope that we will be able to have such information soon.

Senator DURENBERGER. Thank you very much, Jim. I know you have a time bind. Thank you very much for being here.

[Representative Oberstar's prepared statement follows:]

PREPARED STATEMENT OF REPRESENTATIVE JAMES L. OBERSTAR

Mr. Chairman, the focus of these hearings, while important to the people of Minnesota, is far broader and of significance to the residents of all energy importing States who will pay hundreds of billions of dollars into the treasuries of energy-exporting States, which, by the accident of nature, have great supplies of nonrenewable sources of energy.

I know that the Mayor of Minneapolis, and Chairman of the National Coal Consumers' Alliance, Don Fraser, had wanted very much to testify before the Subcommittee, but his official schedule does not permit him to be in Washington today. Mayor Fraser has submitted his statement which addresses the concerns not only of the people of Minneapolis but of mayors throughout the country.

The Supreme Court decision in *Commonwealth Edison Co.* v. *Montana* places the responsibility on Congress to establish reasonable limits on severance taxes. While I would have preferred a more favorable decision on the merits, there is wisdom in the notion that Congress, as the legislative body, and not the Court, should determine which State severance taxes are excessive. Those of us who joined the Court case did not achieve the decision we sought; but we did get what we needed to act: a clear statement that Congress has the authority to determine reasonable standards for energy severance taxes.

In the majority opinion, the Court stated, "The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution."

Justice White, in his concurring opinion, stated the case for Congressional action even more clearly:

"Congress has the power to protect interstate commerce for intolerable or even undesirable burdens. . . . The Constitutional authority and machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress, and surely Montana and other similarly situated States do not have the political power to impose their will on the rest of the country."

The Court has pointed the way for Congressional action and we should act to establish reasonable limits on severance taxes.

In Minnesota, the Montana tax has been the symbol of the burden severance taxes impose upon consumers in energy importing States. Minnesotans pay more of the Montana severance tax than citizens of any other State, and the tax rate is the highest in the Nation.

I am a sponsor of H.R. 1313, the House version of the legislation introduced in the Senate by the Chairman of this Subcommittee. It is a good bill, one which I hope we can enact. While enactment is important to Minnesota, our concern appropriately goes beyond limiting the severance tax charged by Montana. While the rate of Montana's tax is high, the severance taxes charged by oil and gas producing States cost consumers in energy importing States far more and are the source of an even greater threat to our federal system.

I am a co-chairman of the Northeast-Midwest Congressional Coalition. Earlier this month, our research associate, the Northeast-Midwest Institute, published a study of energy severance taxes which estimated that during the decade 1981–1990, projected oil severance tax revenues for Texas will total approximately $35 billion, for Louisiana $45 billion, and for Alaska $29 billion. In 1979, 64 percent of the Texas oil tax was exported beyond Texas' borders, as was 79 percent of the Louisiana tax, and 85 percent of the Alaska tax.

The issue is not the right of a State to impose a reasonable tax to provide essential services to mitigate any damages resulting from the extraction of the energy product and to compensate future generations for the depletion of a nonrenewable energy source. The issue is the extent to which the federal government, and specifically, the U.S. Congress, can permit a small number of energy rich States to charge exorbitant taxes, reap billions of dollars of revenues and effectively shift the cost of their government services from their own residents to those of the other States.

The people of Minnesota are in effect paying for government services provided in Alaska and Texas. Contrary to the principles of our democratic, federal system, the decision on the level of taxation paid by most Americans is being made not by their own representatives, but by the legislatures of a small number of States.

The ability of these States, to assess our constituents these excessive and unreasonable taxes undercuts the notion that we are, first, one Nation, and, second, a union of States. This capability threatens the balance of shared power between the federal government and the State governments.

The fiscal disparities resulting from these taxes can only accelerate the movements of people and capital to energy producing States away from the Northeast and the Midwest. Those who argue that the doctrine of States' rights allows the assessment of any level of severance tax seem to be concerned only about the impact of the tax on the States levying the tax. As federal legislators serving in the United States Congress, we must be concerned about all States including those whose citizens are providing the billions of dollars to the major oil producing States.

We cannot implement effective national policies for the benefit of the United States when individual States exercise the enormous power to tax citizens beyond their borders. In the past, the doctrine of States' rights has been used to justify questionable actions. The fundamental principles of federalism clearly supersede that doctrine when 60, 70, or 80 percent of a tax is paid by the citizens beyond the States' borders. Congress would be derelict if it did not legislate reasonable standards on the imposition of those taxes.

I commend the Subcommittee for holding these 2 days of hearings. I trust they will focus the attention of my colleagues in the House and in the Senate on an issue that demands thoughtful, extensive and careful review.

Senator DURENBERGER. Our next witness is Mayor Morris Lanning, Mayor of Moorhead, Minn. You can describe the geographic location and the problems. I want to compliment you on the sensitivity and the thoroughness that I saw in your statement.

Your full statement will be made part of the record. You can read it or summarize it as you please. Thank you for being here.

Mr. LANNING. Thank you, Mr. Chairman. Thank you very much for the opportunity to be here today. I thank you also for your leadership on this sensitive and important issue to our whole country.

First of all, I would like to submit the formal statement prepared by Mayor Don Fraser of Minneapolis. Mayor Fraser was unable to be here today, and he asked that I submit this statement for him.

Senator DURENBERGER. The statement will be made part of the record.[1]

Mr. LANNING. Moorhead is a community of about 30,000 people located on the North Dakota-Minnesota border. I accepted the invitation to appear here today because of a deep concern over the fiscal disparities which exist between my great State and the State of North Dakota. I would like to submit for the record a short paper which outlines some of the major existing disparities.[2]

There have always been disparities of one sort or another. and there has always been a more or less friendly competition between the two States. However, in recent years, the fiscal disparities have become greater and greater, and we in Minnesota have become less and less able to compete because of North Dakota's ever improving tax and business climate.

What are some of the fiscal disparities that exist? At present, North Dakota's personal income tax rates are, at most, one-third of Minnesota's. Corporate income taxes are on a sliding scale that runs from one-fourth to two-thirds of Minnesota's rate.

To make matters worse, this year North Dakota is experiencing a 31-percent drop in personal income taxes and a 15-percent cut in corporate income taxes because of the estimated $104 million in new revenue which will be collected in oil extraction and coal severance taxes. By 1983 that estimate more than triples and North Dakota could conceivably get to the point where they would become the 11th State without an income tax. North Dakota is also using oil extraction tax moneys to ease the burden on property taxes as well as on income taxes.

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[1] See p. 459.
[2] See p. 491.

What has been the impact of these ever-increasing disparities? Between the years 1920 and 1970, Moorhead's population grew at a percentage rate more than double that of the city of Fargo, our sister city right across the river. Between the years of 1970 and 1980, Moorhead's growth slowed and then stopped. Percentagewise, Fargo's rate of growth exceeds their rate for the previous decade, and it is also about 17 times that of ours. According to the 1980 census, our population has increased by about 300 people over the 1970 census figure. If our two colleges and our technical institution had not significantly increased their enrollments over the last 10 years, we would have experienced a sharp drop in population.

Moorhead's school-age population dropped by nearly 33 percent between the years of 1975 and 1980, and Fargo's dropped by about 11 percent over the same period. As a result of this sharp drop in enrollment, our community has found it necessary to close 6 out of 13 schools. If the current trend continues, we will need to close three or four more schools over the next few years.

Fiscal disparities have also resulted in a great many businesses moving to North Dakota, and untold numbers of businesses never even giving us a second look because of more favorable economic conditions in North Dakota. This has resulted in an average annual employment increase in Fargo of about 3 percent per year over the last 5 years, while our total employment is about 2 percent less than it was in January of 1976.

In general, it could be said that the disparities are numerous, and that they have created a traumatic situation for our community.

What are we doing about it? We have carried our case to the Minnesota Legislature and to the Governor. We have supported tax and spending cuts, as well as numerous policy changes so as to reduce the disparities. The State has responded well. Two years ago, Minnesota enacted the largest tax cut in our history: $750 million. Income tax indexing has been enacted and spending cuts have been made. The State has been working to reduce disparities, but we doubt that it will be enough.

It has been recognized by us that, as Minnesotans, we need blame no one other than ourselves for some of the disparities which exist. Historically, as a State, we have decided that we wanted more services or needed more services than what the people of North Dakota have wanted or felt they needed. As a result, we have consciously decided over the years to pay more in order to live in Minnesota and benefit from better public services. While we are still willing to pay more, Minnesota has now started to apply the brakes. We are working to help ourselves.

But are these efforts doing the job? While we accept the responsibility for what our State may have done to itself, I believe that fiscal disparities go well beyond what we may have done to ourselves or what we may have control over.

The recent budget and tax cutting actions of our State may have only temporarily slowed down the process of increasing disparities. We cannot begin to keep up with North Dakota's ability to increase tax revenues and, at the same time, reduce the tax burden on the individual and the business while improving public services.

What can others do to us or for us? Thus far, the State of North Dakota—and I want to underscore this—has been more reasonable than some other States when it comes to collecting energy taxes. However, current attitudes in North Dakota make us wonder how long more reasonable forces will prevail. We hear very little sympathy and a lot of glee being expressed by North Dakota officials when addressing the subject of fiscal disparities between our States. Some even go so far as to say that it is about time for Minnesota to take a back seat. The Governor of North Dakota is not even trying to hide the fact that he is actively recruiting Minnesota businesses.

We wonder how long it will be before North Dakota might join the ranks of the unreasonable. They are just beginning to really enjoy the sweet taste of megabucks from taxes on energy, as well as from the energy development itself. If they ever did what Alaska is doing, we would be in real trouble.

I believe that North Dakota is definitely entitled to reap significant benefits from energy development, but I ask, "Is the sky the limit?"

Senator **Durenberger**. The big sky?

Mr. **Lanning**. The big sky, right! The "Land of Sky Blue Waters," Minnesota. [Laughter.]

If States cannot or will not impose some reasonable limits upon themselves, who will? How can you expect States to indefinitely remain reasonable when their people are not paying the taxes while people from other States are?

My answer to these questions has led me to conclude that the Federal Government must set some reasonable, high limits on a State's authority to collect taxes on energy development. I am not sure precisely what that limit should be, but in principle all negative impacts resulting from energy development should be covered as well as significant general fund subsidies being allowed. Endowing a State to the point where all other taxes become unnecessary is, in my opinion, going way too far.

Also, since one of the purposes of the coal severance tax is to offset negative impacts of coal development, the Federal Government should consider taking a portion of those severance taxes. This position then, in turn, could be made available to communities in noncoal producing States in order to help them offset the negative impacts of coal development. For example, our city being cut in half by an ever-increasing coal train traffic. The resulting auto-rail conflict is very serious. Currently, there is no program available which can help us solve this problem. Would it not be appropriate for us to receive some of that severance tax revenue, which Montana or other States collect, so we can reduce the negative impact felt by our community, just as those States have tax revenue available to them to offset their negative impacts?

Finally, we ask, "Shouldn't various Federal programs take prevailing fiscal disparities into consideration when determining community allocations?" For example, under present criteria, we do not qualify as a "distressed city" which would, thereby, make us eligible for UDAG grant money. It seems to us that we should be eligible because of the fiscal disparities which we experience. Also, rules determining General Revenue Sharing allocations do not take prevailing fiscal disparities into consideration either. We believe that is wrong.

In general, Mr. Chairman, I do not like having to come to the Federal Government for assistance, but our situation is such that there is only so much we can do for ourselves as a city and as a State. This issue certainly falls into the purview of Federal responsibility.

Thank you for your consideration in this important matter.

Senator **Durenberger**. Thank you very much, Mayor Lanning.

Our next witness is Mayor Ralph Possehl, from the city of Breckenridge, a slightly—only slightly—smaller city, somewhat south of Moorhead but very similarly situated.

Ralph, I am very pleased with your willingness to come here to testify and with all the research that went into your statement. It will be very helpful to us. We welcome you.

Mr. **Possehl**. Thank you, Senator.

My name is Ralph Possehl, mayor of the city of Breckenridge. We are a smaller community than the city of Moorhead, but we are a border city. We also have a sister city of Wahpeton, N. Dak.

Everything you have heard Mayor Lanning say that has happened to them, of course, has happened to us also. We also, about 10 years ago, were about the same size as our sister city. Now they are twice the size and growing fantastically, twice the size of the city of Breckenridge.

We welcome this opportunity to express our thoughts and those of our constituents on the following matters.

According to the North Dakota Tax Commission, the North Dakota budget is set every 2 years for the next biennium. Their budget will be over $2 billion. Between 11 and 12 percent of that $2 billion will be raised through North Dakota Tax Extraction Measure No. 6. The 11½ percent tax is anticipated to raise $430 million. In addition to Measure No. 6, North Dakota currently has a coal severance tax estimated to raise $40 million over the next biennium.

A great part of that revenue is being returned to the counties to cover costs for additional roads and schools because of coal and oil development. However, in a July 12, 1981, editorial from the Fargo Forum entitled, "North Dakota hits a winning streak."[1] the editor stated,

> Another big boost came from interest collected on public funds invested. The estimate from the source was only $6.5 million, but the actual collections were $36.6 million. The interest revenue was more than five times the original estimate.

The editor further states:

> North Dakota finished the 1979–81 biennium with a hard-to-believe revenue collection record for the State's general fund. A look shows the State in the midst of a financial winning streak.
>
> The big gainer was the oil and gas production tax, set at 5 percent in the early days of North Dakota's oil discovery.
>
> The estimate was for $24 million but increased prices and increased production boosted the revenue from this source to $70.4 million. In addition, another $10.2 million was received from the oil extraction tax on which collections began in the last 6 months of the last biennium.

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[1] See p. 194.

While the 1981 Legislature increased the total appropriations . . . from $643.5 million to $680 million, on the final day of the biennium there remained $68 million of this total unspent!

The State of Minnesota was not quite that fortunate in the last 2 years.

Because of Measure No. 6, the coal severance tax and North Dakota's imposed 5-percent gas and oil tax in lieu of property tax, several negative effects will be brought about in Minnesota.

North Dakota residents, who enjoy the benefits of these tax measures, use Minnesota roads and bridges getting to the lake property and/or farm and agricultural properties that they purchase and pay no more property tax than Minnesota residents. The Minnesota resident pays taxes to build and maintain these roads; they pay the taxes for the Department of Natural Resources to control water quality, lakeshore management, stocking of game fish and screening and eradication of rough fish which the nonresident does not.

Also the Minnesota taxpayer pays for police and fire protection in the areas that the nonresident owns lake and/or farm and agricultural properties, for which the nonresident does not pay.

As a result of Measure No. 6 and the additional tax measures that North Dakota has or is proposing, this greatly improves the North Dakota resident's ability to enter the State of Minnesota and purchase these recreational and/or farm and agricultural properties giving them a great advantage over Minnesota residents.

We strongly agree with Mr. Plank in his thinking as stated in the Corporate Report, December 1980. The trend for energy-rich States to add ever higher severance taxes on their mineral resources has to be halted. I don't particularly blame North Dakota for wanting to realize some gain from the depletion of a nonrenewable resource. But I do think there is a level beyond which further taxes become unreasonable.

Again, we believe—along with the article from Corporate Report, December 1980—that energy-rich States can improve their tax attractiveness to businesses by subsidizing their general funds with severance taxes. The result is that businesses end up packing their bags in energy-poor States like Minnesota and moving to the healthier tax climates of places like North Dakota.

A small portion of the money, 10 percent, will go to the State school at Grafton for the retarded. The other 90 percent will be in lieu of other taxes. The State's voters don't seem at all hesitant about cutting their own taxes whenever possible, having done so three times now in recent years.

We, again, agree with Mr. Ray Plank that we are being forced to deal with these States like so many little OPECs.

In conclusion, I feel that if something isn't done, if the Congress doesn't provide legislation regulating the level on which further taxes can or cannot be levied on energy resources, a small number of States will greatly benefit financially at the expense of all the other States who are energy poor.

Thank you for your time and consideration.

Senator **Durenberger**. Thank you, Ralph, very much.

Our last witness on this panel is Dick Kirkham, representing the Minnesota Municipal Utilities Association and the American Public Power Association.

Welcome.

Mr. KIRKHAM. Mr. Chairman, I am Richard Kirkham, executive director of the Minnesota Municipal Utilities Association (MMUA). The Association represents nearly 100 electric utilities throughout Minnesota who serve over 600,000 customers. I am also appearing on behalf of the American Public Power Association (APPA), the national service organization that represents over 1,700 local publicly owned electric utilities in 48 States, Puerto Rico, Guam, American Samoa, and the Virgin Island. See attachment A, resolution of APPA opposing excessive State coal severance taxes.[1]

During the 1970's, our Nation undertook a commitment to become energy self-sufficient. We embarked on a policy of reducing our dependence on foreign oil and maximizing the use of our own natural resources. This policy is reflected in numerous Federal statutes, including the Energy Supply and Environmental Coordination Act of 1974, the Energy Policy and Conservation Act of 1975, the National Energy Act of 1978, and the Energy Security Act of 1980. Underlying these acts is the premise that we have an abundant supply of coal which must be used to curb our appetite for imported and thus unreliable sources of energy.

Accordingly, utilities nationwide have converted their existing plants to coal-fired use, where feasible, and are building new plants which will require coal. Considerable expense is involved in this conversion from liquid to solid fuels. Conversion costs, potential premature retirement of existing generating facilities, higher costs to protect the environment from the adverse effects resulting from increased coal use, all place a heavy financial burden on electric consumers.

While electric utility service is a modern-day necessity, such service needs not necessarily be provided by public power systems. Public power systems can survive and prosper only as long as they are able to supply power to their consumer-owners at the lowest possible cost. Because of this, we in the public power movement must strive to hold down the cost of electricity.

It is for this reason that we are disturbed over what we feel are excessive coal severance taxes in Montana, which has a tax of 30 percent, and Wyoming with a tax of 17 percent. We strongly believe that it is the consumers of this Nation who are being harmed by these excessive severance taxes. The burden does not fall on electric utilities. Through fuel adjustment clauses, costs incurred from severance taxes are routinely passed on to the consumer. Montana State Senator Thomas Towe, author of the Montana severance tax bill, acknowledged this when he said:

> Most of Montana's coal is shipped out of State to power plants and utility companies in the Midwest. . . . (T)he local companies simply add additional taxes to their bill, and the entire cost is passed on to the purchasers in the Midwest or elsewhere. Because most of the purchasers are regulated utility companies, it is reasonable to assume these companies will, in turn, pass on their extra costs to their customers.

Clearly, it is the consumer who shoulders the burden. It is the consumer who pays the severance taxes. We in public power are concerned over the ever-increasing and unjustified costs which the consumers are being asked to pay. By 1987, electricity consumers in 27 States will be paying $360 million each year in Western coal severance taxes alone. See the article attached to my statement titled, "Should U.S. Limit State Severance Taxes?" by Minneapolis Mayor Don Fraser, contained in the November–December 1980 issue of Public Power.[1] A contrasting viewpoint was expressed by State Senator Thomas Towe which is also attached.[2]

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[1] See p. 201.

We are not alone in suggesting that this is a legitimate consumer issue and not—as some have suggested—a matter of concern, and potential enrichment, for electric utilities. The Consumer Federation of America, a highly respected representative of the consumers of this country, has supported limits of 12½ percent on coal severance taxes. See statement of Consumer Federation of America submitted before Subcommittee on Energy and Power of the Committee on Interstate and Foreign Commerce, House of Representatives, 96th Congress, second session, serial No. 96–173.[3]

In the short run, some utilities may be able to avoid using coal from Montana and Wyoming. However, by 1990, more than 30 percent of our Nation's coal needs will be supplied by these two States. One major reason for this is the concentration of low-sulfur coal contained within their borders—approximately 60 percent of the known reserves. This low-sulfur coal is, of course, desirable due to environmental concerns. This desirability creates a demand for this resource, and, in turn, places these two States in an extraordinary economic position.

According to Sally Streiter, vice president, National Economic Research Associates:

> Montana . . . has sufficient power in the coal market that it can continue to raise tax rates and increase tax revenue even while losing production.

The preeminent economic position which Montana holds has recently been reinforced and granted protection against a challenge of unconstitutionality by the U.S. Supreme Court. In *Commonwealth Edison Co.* v. *Montana* (49 U.S. Law Week 4957) the Court found that Montana's severance tax did not violate the commerce clause of the Constitution. Justice Byron White's concurring opinion, however, is very informative. He stated, for him, the case was "very troublesome." He joined the majority "with considerable doubt and with the realization that Montana's levy on consumers in other States may, in the long run, prove to be an intolerable and unacceptable burden on commerce. Indeed, there is particular force in the argument that the tax is here and how unconstitutional."

While he agreed that the Court should hold its hand for now, he continued by suggesting that the "Congress has the power to protect interstate commerce from intolerable or even undesirable burdens."

We believe that it is time for the Congress to recognize that these severance taxes do, at the present, represent intolerable and undesirable burdens. Congress should act affirmatively to set upper limits on State severance taxes.

The impact of severance taxes on utility fuel bills is immediately evident from our experience in Minnesota. In 1980, the following members of our Association paid these approximate amounts in Montana severance taxes:

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[1] See p. 201.

[2] See p. 204.

[3] This statement may be obtained from the Committee on Interstate and Foreign Commerce, U.S. House of Representatives.

Hibbing Public Utilities Commission	$312,000
Virginia Department of Public Utilities	228,000
Willmar Municipal Utilities Commission	134,000
Detroit Lakes Public Utilities Department	13,200

Municipally owned utilities and other coal users, except for the two largest investor-owned utilities, paid $2.5 million in severance taxes. The two investor-owned utilities—Minnesota Power Co. and Northern States Power—paid $4.9 million and $11.28 million, respectively, in severance taxes for Montana coal.

Our members' need for Western coal will continue to grow in the future. Two joint action agencies—Southern Minnesota Municipal Power Agency and United Minnesota Municipal Power Agency—are purchasing a 44-percent interest in Sherco 3, a Minnesota plant committed to use Montana coal. Once on line, it will burn 2.5 million tons of coal annually. At current rates, severance taxes are estimated at $4,375,000 annually.

This situation is not unique to Minnesota; rather, it is one felt throughout the Midwest. In a statement last year before the House Subcommittee on Energy and Power, a spokesman for the Nebraska Public Power District indicated that they have a 20-year contract to purchase 3.6 million tons of Wyoming coal annually.

At rates then in effect, the District paid $1.05 per ton in severance taxes, or $3.78 million annually. The spokesman estimated the District could save 23 cents per ton if the Congress had passed a bill similar to S. 178.[1] He also stated that the District would not purchase Montana coal because of its high severance taxes.

Publicly owned electric utilities in Kansas are paying comparable sums to meet their coal needs. The Kansas City Board of Public Utilities recently entered into a contract for Wyoming coal. The Board estimates it will pay $670,000 in severance taxes in 1981; however, if S. 178 is passed, this amount would be reduced and consumers would thus save $70,000. In the future, the Board expects its coal requirements will increase 3 to 4 percent annually, and it will pay a corresponding increase in taxes. The Kansas Municipal Energy Agency, a joint action agency, is negotiating with Kansas City Power & Light and Kansas Gas & Electric for an interest in two coal-fired plants, La Cygne Units 1 and 2. The latter unit burns Western coal. This agency is also negotiating with Sunflower Electric Cooperative for a share in the Holcomb coal-fired plant that will burn Western coal.

Finally, the experience of two public utilities in Texas is illustrative of the impact that severance taxes have on fuel bills. The San Antonio City Public Service Board has a 20-year contract for Wyoming coal under which it expects to purchase 55 million tons of coal. In 1980 alone, it paid out over $1 million in ad valorem taxes. Similarly, the Lower Colorado River Authority, together with the city of Austin, has a 25-year contract for 50 million tons of Montana coal to be used in its Fayette Power Project. Between late 1978 and early 1981, they paid $21.5 million in severance taxes. Overall, the utilities estimate they will each pay $100 million attributable to severance taxes.

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[1] See p. 507, for text of S. 178.

These figures are representative of the burden presently being placed on utilities and their consumers. Over the long term, it is estimated that by 1990, 35 percent of the Nation's coal needs will be satisfied by Montana and Wyoming.

Minneapolis Mayor Don Fraser, in the article from "Public Power" which I mentioned earlier, estimates that, by 1987, electricity consumers in 27 States will be paying $360 million annually in severance taxes. These figures, however, do not reflect escalation clauses which are generally in every coal contract.

We recognize, of course, that severance taxes are only one factor responsible for the increase in utility bills. Another is the exorbitant rates charged by railroads to ship coal. MMUA, APPA, and its member utilities have fought vigorously in the Congress and before the Interstate Commerce Commission to keep rates reasonable and service adequate. However, if we put this issue aside, there is some correlation between the rates charged for coal transportation and the benefits received by consumers. In return for paying these freight charges, consumers receive the coal needed to generate electricity. In contrast, consumers pay higher utility bills to meet the costs of paying severance taxes; yet they receive no direct benefit from the services that these States provide to their citizens through these revenues.

The issue is who assumes the costs involved with removing the coal. The State of Montana rightfully claims that it should be reimbursed for the costs, direct and indirect, incurred from mining the land—reclamation, roads, public services for miners and communities, and mining-related services. However, Montana already receives reimbursement for these expenses through Federal royalty payments, State property taxes, and other moneys paid by coal companies. Three Federal acts—the Mineral Leasing Act of 1976, the Surface Mining Control and Reclamation Act of 1977, and title VI of the Power Plant and Industrial Fuel Use Act of 1978—provide substantial sums for reclamation and some moneys for other related impacts of mining.

By 1990, Montana, through two State taxes together with the severance tax, will collect 30 times the amount necessary to cover environmental and social costs arising from mining. If S. 178 is passed, the State would still receive 10 times the needed amount.

Finally, Montana requires mining companies to post a bond for the full cost of reclamation. This bond is held for up to 10 years after mining ceases to insure reclamation is done properly.

We believe that the record is clear. Severance taxes imposed by Montana and Wyoming already have become unduly burdensome. They are injurious to the national interest. We are striving to become energy self-sufficient by relying on our own resources, yet these taxes thwart that effort. We have established a national commitment to meet that goal. Indeed, these States, by exploiting resources fortuitously within their boundaries, are causing divisions between themselves and regions that don't have such resources.

The Federal Government has a strong basis upon which to act. Seventy-five percent of Montana's coal is located on federally owned lands—lands which should be used for the benefit of the entire public. Montana is taking undue advantage of these lands to benefit solely the citizens of its State at the expense of consumers nationwide.

It is therefore incumbent on the Congress to balance the national interest in making the greatest use of coal, against the States' right to be compensated for costs in extracting it. We feel S. 178 strikes this balance well and we urge its enactment.

Thank you for this opportunity to present our views.

Senator **Durenberger.** Thank you very much for your statement.

Mayor Lanning, it seems to me you put your finger on one of the fundamental distortions that this situation produces when you talked about what Minnesota is doing to help itself.

In a historical sense, you are correct when you say that Minnesota decided a long time ago that it desired and needed a high level of public services. So generations ago we made a commitment that we were also going to pay for it.

There has always been a vigorous debate within the State of Minnesota over exactly how much we should spend, but basically, it was within the State. It was Minnesota politics. People were in effect trading off part of their earnings for a higher level of public services. Now Minnesotans for the first time are starting to discover that in the present economic conditions it just may not be possible to continue the level of services which they have traditionally enjoyed. They are starting in a variety of ways at all levels of government to make the hard choices to cut back.

But the disturbing part to me, and in a sense the outrageous part, is that Minnesota politics and the politics of a lot of other consuming States, I am sure, are being directed to a great extent by forces which are totally beyond our control.

When that force is OPEC, it is a troublesome reality with which we must learn to live. But when it is somebody else's legislature or somebody else's tax commissioner, then it seems to me we are getting into an intolerable situation.

I would be curious to know your feeling as to the degree of sensitivity within a State like Minnesota for this problem. I have heard you speak. I have heard Ralph speak. You represent two border cities where you can directly see the impact. I am concerned to know whether in a larger sense Minnesotans and maybe particularly the business community—the job creators in our State—really fully appreciate the extent of this problem. Have they been too preoccupied with working on workers' compensation and some of those kinds of things to fully understand what is happening to fiscal capacity?

Mr. **Lanning.** Whether the business community understands and appreciates that? I am not really sure about that. Minnesota has had good business climate for a long time. However, it is my feeling and my observation. and the observation of a lot of people, that our business climate in the State is rapidly deteriorating. We are seeing situations where Minnesota business people are beginning to say that the business climate in the State is such that they are going to have to look elsewhere for business expansion and maybe even relocate their companies.

The whole matter relates not only to corporate income taxes and personal income taxes, but also as you mentioned something like workers' compensation in which there is a great disparity between our two States.

I guess I don't know if I can add any more to that.

Senator **DURENBERGER.** One of the other things which you talked about was the negative impacts of coal development in noncoal States or in coal consuming States.

Could you give a little more detail to the spillover effects of coal development on neighboring States like Minnesota? You mentioned the rail problem as certainly one effect. Maybe you can expand on that a little bit more.

Mr. **LANNING.** We have always had an auto-rail conflict because, historically, our community and many communities in our part of the State were built up around the railroad. However, with the increasing coal train traffic, moving coal out East primarily, our community is cut in half for longer periods of time during the day.

We do not have the resources to undertake urban renewal projects in order to provide grade separations to reduce this conflict. We have even looked at the possibility of rerouting rail traffic around our cities, but the costs of that are just astronomical. We couldn't begin to undertake that kind of a project.

I really believe that, if the severance tax is intended to offset negative impacts, it seems to me that we can clearly document our negative impacts from coal development.[1] We ought to get some relief as a result of that problem.

Senator **DURENBERGER.** Ralph, you mentioned Measure No. 6 in North Dakota. Could you explain for us just exactly what that referendum matter was in North Dakota?

Mr. **POSSEHL.** Yes. In the last general election, North Dakota people voted on Measure No. 6, which was whether the State would have the authority to place, in effect, a tax on the severance or the production of mining coal. North Dakota voters passed this. At that time it was called Measure No. 6.

Senator **DURENBERGER.** As I recall the only major problem with that among North Dakotans was who was going to benefit from it. It wasn't really whether or not they ought to sock it to the minerals which were being extracted. It was really sort of an East-West issue in North Dakota as to who was going to get the benefit of the tax. Am I correct?

Mr. **POSSEHL.** This debate is still going on because at the township, county and State levels they are still debating as to who is going to be the beneficiary of all of these remedies. At the present time, they haven't made that decision. To further complicate the thing, the North Dakota Supreme Court has ordered the holding of disbursement of these funds until some decisions can be made. I feel that the North Dakota officials are not really sure as to the constitutionality of it at this time, because no disbursements are being made until the Court further orders.

Senator **DURENBERGER.** Let me go back over some of the figures which you gave us. As I recall, the budget estimate for the coming biennium was $2 billion in North Dakota. About $230 million of that was coming from Measure No. 6, the 6½ percent tax on extraction. In addition to that, the coal severance taxes were estimated to raise $40 million.

Mr. **POSSEHL.** That is right.

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[1] See p. 510.

Senator DURENBERGER. The 5-percent oil and gas tax, which was in lieu of a property tax, would raise around $200 million. Then the interest on their investment fund was $6.6 million. I wasn't clear whether that was the total or whether some of those figures out of the North Dakota paper added to that figure. That is about $500 million out of $2 billion. Is that about what the estimate is for just the next 2 years? What is the percentage?

Mr. POSSEHL. Yes, that is approximately the estimate or a combined total of what revenues have been, although the estimates were lower. However, because of increases in the price of the coal and the oil, and increased production as the editor of the paper goes on to state, the big surprise for everyone was the amount of interest received which is included in this figure. They thought $6 million, but the interest for that period was $36 million because of their ability to use these funds, apparently, without any other need except to deposit them in high yield certificates of deposit allowing an interest return.

Senator DURENBERGER. So, just in the next 2 years, we are looking at 25 percent of the North Dakota budget, at least, coming from mineral-related taxes.

Mr. POSSEHL. That is right.

Senator DURENBERGER. Along with your statement, which will be made a part of the record, we will also make a part of the record some business-related articles.[1] We can go through these articles together and decide which are most appropriate to mention.

The project which you and I worked hardest on was about a $4.5 million sunflower seed processing plant. I say "you and I worked hard on it," because about the only way a Minnesota city is going to be able to compete with a North Dakota city is by going to the Federal Government and trying to get some concessions out of UDAG or some of those programs. As I understand it, despite all those efforts, even with some of the Federal commitments, you lost out on the sunflower seed plant.

Mr. POSSEHL. Yes; we did. Mayor Lanning spoke a while ago of Moorhead's inability to be declared a distressed city, making them at this point not eligible for UDAG grant participation.

The city of Breckenridge had the distinction of being declared a distressed city in some other things. This made us eligible for—and we made application for and were successful in obtaining, with the Senator's help—a $4.5 million grant in urban development through HUD which we thought was going to be more than instrumental. We thought it would nail the project down because the $4.5 million grant that the city could use was a low-interest loan of 6 percent to the developer at a time when the prime rate was around 18, 19, and 20 percent. Under most circumstances we should have been able to secure that type of development.

However, as the evidential material in back of my statement will show, it didn't phase our neighboring State. They have a 5-year tax abatement on State income taxes and/or real estate taxes for these companies which they offer as the companies come into the State. The $4.5 million grant became very tempting for the developer at this stage because it was a little more than the tax abatement that North Dakota offers companies to come and build factories and do business in their

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[1] See p. 523.

State. However, it didn't take North Dakota long to make another 5-year tax abatement on all State income taxes regarding the sunflower seed plant.

So again that and other tax problems and disparities which Mayor Lanning and you mentioned—such as workers' compensation, State income taxes and so forth—we experienced through two very good developers and very good companies. They made the decision to build in North Dakota.

Senator **Durenberger**. I want to accent that point. I want it made a part of this record. Any other evidence that we have of this nature I think is terribly important.[1] Because the reason we are having this hearing here in the Intergovernmental Relations Subcommittee and not over in the Energy Committee where you talk about passing a bill on the severance taxes is that my concern, and the concern of mayors and Governors all over this country, ought to be for the survival of the Federal system.

This is the best example I can think of and the most current one. It is nothing compared to what we are going to see 2, 3, or 4 years from now. This Congress has got to take some action on this issue.

We are flooded with rhetoric about returning power to the State and local governments. I mean it overwhelms us. We are all part of that effort because we all know it works better back there. You would be the first to tell us that.

Downstairs on the second floor they are having hearings today on something called "Urban Enterprise Zone," the great salvation to the cities of this country. They are going to tell you that, with a few tax breaks for businesses, you are going to be able to solve all of these problems. What they are going to do, in the process, is get rid of UDAG and, in effect, take the Federal Government out of the business of interacting with community development. So, you are going to get left out there competing with Texas, Alaska, and California.

I am glad we are talking about North Dakota because you and I know North Dakota is a great State, like Minnesota. However, it tends to get neglected a lot in the Federal system. It is a powerful State. Its people are powerful. Its economics are powerful. Now its minerals are obviously giving them the tools to really do in a State like Minnesota.

So, that is an important example of why this concern takes place in the Intergovernmental Relations Subcommittee. I hope by the Fall we will have people who care about people, like you people, who—as mayors, Governors and so forth from the mineral-rich States—come in here and talk to us the same way you have.

Dick, I want to ask you about—as long as you have talked about some of the Federal role issues—one of the important issues which hasn't come up yet. We have talked about the role of the Congress in setting some kind of policy with regard to State taxes. But we haven't talked a lot about the role that Congress is already playing, to offset the burden of State taxation. One of these is the whole business of royalties, the present royalties on Federal lands.

We talked earlier about 75 percent of Montana coal as being on Federal land. The present royalty is 12½ percent of the value of the coal.

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[1] See p. 195.

Of that royalty, 50 percent is going to Montana, 50 percent going to the U.S. Government, the people who own it. As you pointed out, about 80 percent of that 50 percent which comes to us is effectively being devoted to mine land reclamation and a variety of other things to offset the costs of that extraction. So, the net effect is that 90 percent of the royalty collected goes back to the State of Montana to offset these costs. A dinky little 1.2 percent of the value of the coal or something like that, ends up in the Federal Treasury.

Another reason I think we have to be concerned—and I ask you to reflect on this—is that we now have a Secretary of Interior who, when he gets done with offshore stuff, is apparently coming onshore and going to do something about the continued leasing of Federal lands. He will propose a system where 90 percent of the money is going right back to the States, or if you are in Alaska, 100 percent.

Am I wrong in expressing a concern for the role that the Federal Government is already playing in expanding the fiscal disparities between the energy mineral States and those without the minerals?

Mr. KIRKHAM. No, sir. I don't think you are at all wrong. Obviously, the Federal lands play a very, very important role in the production of energy in this country. I think the Federal Government has every reason to do what it can to assure that the benefits of the energy and resources on Federal lands are fairly distributed in the country. Besides making it available to the country, I think it is very, very important that the economic and development benefits for developing those resources should be spread evenly across the country, by doing something to prevent the accidental location of the State boundaries from having an adverse impact. We should not allow certain States to unnecessarily enrich themselves at the expense of the rest of us who use those resources which accidentally happened to have been encompassed with the State boundaries in the past.

Senator DURENBERGER. Do you happen to know what proportion of the electricity bought by Minnesota comes from North Dakota power plants?

Mr. KIRKHAM. From North Dakota?

Senator DURENBERGER. Yes.

Mr. KIRKHAM. It is a rather small proportion. They export a certain amount of electricity in the Red River Valley. The United Power Association and the Consumers Power Association, which provides electricity to primarily rural areas, export energy from North Dakota plants. I really couldn't say with any exact degree what percentage that is. But it is a relatively small percentage.

Senator DURENBERGER. Is there any doubt in your mind that the severance tax on the lignite, which is consumed to generate that power, is also exported to a State like Minnesota, or to any purchasers of that electricity?

Mr. KIRKHAM. Sure. I have no doubt about that.

Senator DURENBERGER. Thank you all very much for your testimony. We appreciate your being here.

[The prepared statements of Mr. Lanning and Mr. Possehl, with attachments, and attachments submitted by Mr. Kirkham follow:]

PREPARED STATEMENT OF MORRIS L. LANNING

Mr. Chairman and Members of the Committee:

I am Morris Lanning, Mayor of Moorhead, Minnesota, a community of 30,000 people, located on the North Dakota-Minnesota border. I accepted the invitation to appear here today because of a deep concern over fiscal disparities, which exist between my great state and the state of North Dakota.

There have always been disparities of one sort or another, and there has always been a more or less friendly competition between the two states. However, in recent years, the fiscal disparities have become greater and greater, and we in Minnesota have become less and less able to compete because of North Dakota's ever improving tax and business climate.

What are some of the fiscal disparities that exist?

At present, North Dakota's personal income tax rates are, at most, 1/3 of Minnesota's. Corporate income taxes are on a sliding scale that runs from 1/4 to 2/3's of Minnesota's rate. This year, North Dakota is experiencing a 31% drop in personal income taxes, and a 15% cut in corporate income taxes because of the estimated $104,000,000 which will be collected in oil extraction and coal severence taxes. By 1983, that estimate more than triples and North Dakota could conceivably get to the point where they would become the 11th state without an income tax. On the other hand, Minnesota has one of the highest income tax rates in the country. Therefore, this disparity spells real trouble for those of us who live along the border.

Secondly, even though Minnesota has in recent years eased more and more of the tax burden from the property tax to the income tax, North Dakota property taxes are 1/3 to 1/2 of what they are for Minnesota commercial and industrial properties. North Dakota is using oil extraction tax money to ease the burden on the property tax, as well as its income tax. Public education supported by the property tax in North Dakota is one of the major beneficiaries of the 6-1/2% oil extraction tax. Time does not permit me to discuss other fiscal disparities which exist, such as the gas tax, worker's compensation and property tax abatements. Suffice it to say that over all, the disparities between our two neighboring states are about as great as you will find anywhere in the country.

What has been the impact of these ever-increasing disparities?

Between the years 1920 and 1970, Moorhead's population grew at a percentage rate more than double that of the City of Fargo. Between the years 1970 and 1980, Moorhead's growth slowed, and then stopped. Percentage wise, Fargo's rate of growth exceeds their rate for the previous decade, and also about 17 times that of ours. According to the 1980 census, our population has increased by about 300 people over the 1970 census figure. If our two colleges and our technical institution had not significantly increased their enrollments over the last 10 years, we would have experienced a sharp drop in population.

Moorhead's school-age population dropped by nearly 33% between the years of 1975 and 1980, and Fargo's dropped by about 11% over the same period. As a result of this sharp drop in enrollment, our community has found it necessary to close 6 out of 13 schools. If the current trend continues, we will need to close 3 or 4 more schools over the next few years. Fiscal disparities have also resulted in a great many businesses moving to North Dakota, and untold numbers of businesses never even giving us a second look because of more favorable economic conditions in North Dakota. This has resulted in an average annual employment increase in Fargo of about 3% per year over the last 5 years, while our total employment is about 2% less than it was in January of 1976.

In general, it could be said that the disparities are numerous, and that they have created a traumatic situation for our community.

What are we doing about it?

We have carried our case to the Minnesota Legislature and to the Governor. We have supported tax and spending cuts as well as numerous policy changes so as to reduce the disparities. The State has responded well. Two years ago, Minnesota enacted the largest tax cut in our history, $750,000,000. Income tax indexing has been enacted and spending cuts have been made. The State has been working to reduce disparities, but we doubt that it will be enough. It has been recognized by us, that, as Minnesotans, we need blame no one other than ourselves for some of the disparities which exist. Historically as a state, we have decided that we want more services or need more services than what the people of North Dakota have wanted or felt they need. As a result, we have consciously decided over the years to pay more in order to live in Minnesota and benefit from better public services. While we are still willing to pay more, Minnesota has now started to apply the brakes. We are working to help ourselves.

But are these efforts doing the job?

While we accept the responsiblity for what our state may have done to itself, I believe that fiscal disparities go well beyond what we may have done to ourselves or what we may have control over. The actions of our state have only temporarily slowed down the process of increasing disparities. We cannot begin to keep up with North Dakota's ability to increase tax revenue and, at the same time, reduce the tax burden on the individual and the business.

Furthermore, energy tax collections in North Dakota have now enabled the state to significantly improve public services, while still being able to reduce the tax burden on the people and businesses of the state. Our edge in the quality and quantity of public service is diminishing, and it will likely continue to diminish.

What can others do to us or for us?

Thus far the State of North Dakota has been more reasonable than some other states when it comes to collecting energy taxes. However, current attitudes in North Dakota make us wonder how long more reasonable forces will prevail. We hear very little sympathy and a lot of glee being expressed by North Dakota officials when addressing the subject of fiscal disparities between our states. Some even go so far as to say that it is about time for Minnesota to take a back seat. The Governor of North Dakota is not even trying to hide the fact that he is actively recruiting Minnesota businesses.

We wonder how long it will be before North Dakota might join the ranks of the unreasonable. They are just beginning to really enjoy the sweet taste of megabucks from taxes on energy, as well as from the energy development itself. If they ever did what Alaska is doing, we would be in real trouble.

I believe that North Dakota is definitely entitled to reap significant benefits from energy development, but, I ask, "Is the sky the limit?" If states cannot or will not impose some reasonable limits upon themselves, who will? How can you expect states to indefinitely remain reasonable when their people are not paying the taxes while people from other states are?

My answer to these questions have led me to conclude that the federal government must set some reasonably high limits on a states authority to collect taxes on energy development. I am not sure precisely what that limit should be, but in principle all negative impacts resulting from energy development should be covered as well as significant general fund subsidies being allowed. Endowing a state to the point where all other taxes become unnecessary is, in my opinion, going way to far.

Also, since one of the purposes of the coal severence tax is to offset negative impacts of coal development, the federal government should consider taking a portion of those severence taxes which then, in turn, can be made available to communities in non-coal producing states to help them offset the negative impacts of coal development. For example, our city is being cut in half by an ever-increasing coal train traffic. The resulting auto-rail conflict is very serious. There currently is no program available which can help us solve this problem. Would it not be appropriate for us to receive some of that severence tax revenue so that we can reduce the negative impact felt by our community.

Finally, we ask, "Shouldn't various federal programs take prevailing fiscal disparities into consideration when determining community allocation?" For example, under present criteria, we do not qualify as a "distressed city" thereby making us eligible for UDAG grant money. It seems to us that we should be eligible. Also, rules determining federal revenue sharing allocations do not take prevailing fiscal disparities into consideration either.

In general, I do not like having to come to the federal government for assistance, but our situation is such that there is only so much we can do for ourselves as a city and as a state. This issue certainly falls into the purview of Federal responsibility.

Thank you for your consideration in this important matter.

Morris L. Lanning
Mayor of Moorhead, Minnesota

PREPARED STATEMENT OF MR. POSSEHL

Dear Members of the Senate Intergovernmental Relations Subcommittee, our City Attorney had a telephone conversation with the North Dakota State Tax Commissioner on July 10, 1981, where the Commissioner informed us that the North Dakota Budget is set every two years. For the 1981 and 1982 years, the budget will be just over $2 billion. It is estimated that between 11 percent and 12 percent of the $2 billion will be raised through Measure Number 6. The 6½ percent tax on extraction is anticipated to raise $230 million in the next biennium. In addition to Measure Number 6, North Dakota currently has a coal severance tax estimated to raise $40 million revenue over the next biennium. In addition to these two taxes already mentioned, North Dakota imposes a 5 percent oil and gas tax in lieu of a property tax raising $200 million. A "great part" of that being returned to the County for reimbursement of impacts resulting in local development caused by the increase in population and the need for additional roads and schools.

However, in an editorial from the Fargo Forum entitled, "N. D. hits a winning streak" published on July 12, 1981, the editor states: "Another big boost came from interest collected on public funds invested. The estimate from the source was only $6.5 million but the actual collections were $36.6 million. The investments didn't produce quite as well as the oil wells, when comparing the total amount collected, but the interest revenue was more than five times the original estimate, while the oil and gas production revenue from both the old and new tax was just a little more than three times the original estimate."

The Fargo, North Dakota Editor further states, "North Dakota finished the 1979–1981 biennium with a hard-to-believe revenue collection record for the state's general fund. A look at the figures shows a state in the midst of a financial winning streak." "The big gainer, of course, was the oil and gas production tax, set at 5 percent in the early days of North Dakota's oil discovery. The estimate was for only $24 million but increased prices and increased production boosted the revenue from THIS source to $70.4 million. In addition, another $10.2 million was received from the oil extraction tax on which collections began in the last six months of the last biennium." "There was another healthy development in the financial department on the other side of the ledger. While the 1981 Legislature increased the total appropriations for the last biennium with some extra spending in the six months between January and June, raising the total of authorized appropriations from $643.5 million to $680 million, on the final day of the biennium, there remained $68 million of this total UNSPENT!"

Because of Measure Number 6, the Coal Severance Tax and North Dakota's imposed 5 percent gas and oil tax in lieu of property tax, several negative effects will be brought about in Minnesota.

(1) North Dakota residents who enjoy the benefits of these tax measures use Minnesota roads and bridges getting to the lake property and/or farm and agricultural properties that they purchase and pay no more property tax than Minnesota residents.

(2) The Minnesota resident pays taxes to build and maintain these roads, they pay the taxes for the Department of Natural Resources to control water quality, lakeshore management, stocking of game fish and screening and eradication of rough fish which the non-resident does not.

(3) Also the Minnesota taxpayer pays for police and fire protection in the areas that the non-resident owns lake property and/or farm and agricultural properties which the non-resident does not pay.

(4) As a result of Measure Number 6 and the additional tax measures that North Dakota has or is proposing, this greatly improves the North Dakota resident's ability to enter the State of Minnesota and purchase these recreational and/or farm and agricultural properties giving them a great advantage over Minnesota residents.

(5) We strongly agree with Mr. Plank in his thinking that the trend for energy-rich states to add ever higher severance taxes on their mineral resources has to be halted. The real question here is how far this is going to spread and when the federal government is going to assume the role of final arbiter. I don't particularly blame North Dakota for wanting to realize some gain from the depletion of a nonrenewable resource. But I do think there is a level beyond which further taxes become unreasonable.

(6) We believe along with the article from Corporate Report, December 1980, that energy-rich states can improve their tax attractiveness to businesses by

subsidizing their general funds with severance taxes. The result, the argument goes, is that businesses end up packing their bags in energy-poor states like Minnesota and moving to the healthier tax climates in places like North Dakota. The debate over the tax in North Dakota has turned on a somewhat murky amalgamation of self interests. A small portion of the money, 10 percent, will go to the state school for the retarded at Grafton; the other 90 percent will be evenly divided between education and property and income-tax relief. The state's voters don't seem at all hesitant about cutting their own taxes whenever possible, having done so now three times in recent years.

(7) "In the meantime, we're being forced to deal with these states like so many little OPECs," as quoted from Corporate-Report, December 1980, Ray Plank.

In conclusion, I feel that if something isn't done and Congress doesn't provide legislation regulating the level on which further taxes can or cannot be levied on energy resources, a small number of states will greatly benefit financially at the expense of all the other states who are energy poor.

[From the Forum, July 12, 1981]

N.D. HITS A WINNING STREAK

North Dakota finished the 1979–81 biennium with a hard-to-believe revenue collection record for the state's general fund. A look at the figures shows a state in the midst of a financial winning streak.

When the 1979 Legislature set the budget for the two-year period which expired last June 30, the general fund revenue estimate was $555 million. The Legislature appropriated $654.8 million, with the difference to be financed out of the then general fund surplus of $148 million.

Collections, however, exceeded the estimates by about $92.5 million. The general fund revenue jumped up to $647.5 million even though sales tax collections, for instance, were $13 million under the 1979 estimate. The income tax collections were up about $18 million, despite the tax reduction voted by the people in 1978.

The big gainer, of course, was the oil and gas production tax, set at 5 percent in the early days of North Dakota's oil discovery. The estimate was for only $24 million but increased prices and increased production boosted the revenue from this source to $70.4 million. In addition, another $10.2 million was received from the oil extraction tax, 6½ percent, approved by the voters last November and on which collections began in the last six months of the last biennium.

Another big boost came from interest collected on public funds invested. The estimate from the source was only $6.5 million, but the actual collections were $36.6 million. The investments didn't produce quite as well as the oil wells, when comparing the total amount collected, but the interest revenue was more than five times the original estimate, while the oil and gas production revenue from both the old and new tax was just a little more than three times the original estimate.

The estimates for the insurance premium tax, the cigarette tax, and the liquor and beer taxes were just about on the nose and combined to bring in about $45 million.

The coal severance tax did not keep pace with oil revenues in any fashion. The original estimate was that the severance tax would bring in $8.7 million and the total for the biennium was $9 million.

There was another healthy development in the financial department on the other side of the ledger. While the 1981 Legislature increased the total appropriations for the last biennium with some extra spending in the six months between January and June, raising the total of authorized appropriations from $643.5 million to $680 million, on the final day of the biennium there remained $68 million of this total unspent. Some of this money will go out in the next few months on the basis of commitments made prior to the end of the biennium. The final total will not be available immediately from the Department of Accounts and Purchases.

The net result of the increase in collections and the savings in expenditures meant that the general fund balance increased by at least $24 million and maybe as much as $36 million, depending upon the final adjustments made in the unexpended appropriations. This is indeed a rosy financial picture, but we should be reminded that North Dakota benefited by high interest rates paid on investments and the higher prices paid for a much greater oil production than had been anticipated. The combined revenue from these two sources was $86 million over the 1979 estimates. Without these windfalls, the cash balance in the general fund would have shrunk to below $100 million, and there would have been no way to finance the billion-dollar budget approved by the 1981 Legislature.

[From the Fargo Forum, July 12, 1981]

COURT ORDERS DELAY IN OIL TAX ALLOCATION

BISMARCK, N. DAK.—A hearing scheduled for July 15 by the North Dakota Supreme Court came with a high court order Friday restraining a state official from allocating Measure No. 6 energy tax funds.

"In order to preserve the status quo," the high court restraining order read, "the State Treasurer, John Lesmeister, is hereby ordered and commanded to refrain from making allocations and distributions of the funds derived from Initiated Measure No. 6 until further order of this Court."

The high court ordered the respective parties in the dispute to appear before it at 1:30 p.m. July 15 or as soon thereafter as the matter can be heard for arguments in a show cause proceeding on continuation of the restraining order.

Energy industry officials had filed earlier a court case challenging the constitutionality of Measure No. 6, which is a 6½ percent tax on oil passed by North Dakota voters atop the regular 5 percent oil and gas tax.

And the Rocky Mountain Oil and Gas Association and the North Dakota Petroleum Council said Thursday that the state is breaking a promise to keep the funds in a special unallocated account until the court case is settled. If the industry wins, refunds could be required. Friday, the industry representatives appealing the tax asked the high court for a writ of prohibition to hold up the allocations. They asked the court to prevent Lesmeister from apportioning the $23.6 million in first-quarter collections from the tax.

[From the Fargo Forum, July 12, 1981]

ONCE MORE, WITH SPIRIT, "AMERICA (N.D.) THE BEAUTIFUL"

(By Charles T. Ross, Jr.)

To the Editor:

After living nearly 75 years in North Dakota, my sympathy goes out to Minnesota and other Eastern states which resent North Dakota oil and coal taxes.

We buy our groceries and produce from grocery chains, all based in Minnesota.

Our grain is hauled by Minnesota-based railroads, which were given alternate sections of land in North Dakota to help build rail lines, which they are now abandoning. But they keep the "goodies" which in the larger cities include the "Main Street" which they lease back to the merchants—and let's not forget their own coal lands in western North Dakota, coal that they haul East in mile-long trains of coal cars.

Our North Dakota grain is handled in the main by Minnesota corporations. Mills in Minneapolis mill our flour and many of our cereals as well as macaroni products. Some of our largest banks are branches of Minneapolis banks, as are our hardware stores. The iron used in our machinery and cars comes from the ore mined at Hibbing, Minn. Our trucks, cars, machinery, lumber, furniture, glass, cement, fertilizer, fresh fruits and vegetables etc. etc. come from other states of the union.

And now! North Dakota has oil and coal. And so, please—gently and with compassion—give the screw another small twist, because that has been the American and Minnesota way for 100 years. And let the band play "America the Beautiful" because we are beginning to love it this way.

[From Corporate Report, December 1980]

TAXING 'EM WHILE THE TAXING IS GOOD

Sometimes it seems nobody likes the oil companies. Include the voters of North Dakota, certainly, who last month approved an initiated measure to add a six-and-one-half-percent extraction tax on all oil produced in their state. The new tax effectively more than doubles the tax on oil in North Dakota, where a five-percent oil and gas production tax was already in place. The immediate impact of the tax will be to take about $1.80 right off the top of every barrel of oil produced and make a lot of oil companies angry.

While the $1.80 loss per barrel isn't enough margin of difference to affect the drilling and exploration of most oil producers, it's a particularly annoying tax because there is no way to pass it on.

Oil prices are set in the international market, and if producers out in the Williston Basin suffer a bit on the cost side there's nothing they can do but absorb it.

The tax has had the somewhat unlikely effect of causing one local oil company executive to call for federal intervention. Ray Plank, chairman and chief executive officer of Apache Oil Corp. in Minneapolis, thinks the trend for energy-rich states to add ever-higher severance taxes on their mineral resources has to be halted.

"The real question here is how far this is going to spread and when the federal government is going to assume the role of final arbiter," Plank says. "I don't particularly blame North Dakota for wanting to realize some gain from the depletion of a nonrenewable resource. But I do think there is a level beyond which further taxes become unreasonable."

Plank's solution would be to have the federal government impose an absolute ceiling on severance taxes levied by the states. Meanwhile, Plank says, the oil industry will have to get busy and try to educate voters on ill-advised escalations in severance taxes. Plank personally supports initiative and referendum, and says recent experience in California—where a strong public lobbying effort by the oil industry stopped a similar measure—shows that the cost of taking the industry's case to the voters is well worth it.

The larger concern, Plank says, has to be that such taxes can heighten the economic imbalances between energy-rich and energy-poor states. The petroleum industry contends that energy rich states can improve their tax attractiveness to businesses by subsidizing their general funds with severance taxes. The result, the argument goes, is that businesses end up packing their bags in energy-poor states like Minnesota and moving to the healthier tax climates in places like North Dakota.

The debate over the tax in North Dakota has turned on a somewhat murky amalgamation of self interests. A small portion of the money, 10 percent, will go to the state school for the retarded at Grafton; the other 90 percent will be evenly divided between education and property and income-tax relief. North Dakota's educational system is a mess, financially and otherwise, and the money is badly needed there. The state's voters don't seem at all hesitant about cutting their own taxes whenever possible, having done so now three times in recent years.

Well, the oil companies came up on the losing end this time, and Ray Plank (who often speculates aloud what Minnesota might do for its tax base if taconite sold for the same price as oil) is certainly not alone in wondering when the government will see that it has to act to normalize severance taxes.

"Right now, I'm kind of pessimistic about it," Plank says. "The temptation for the states to act in this fashion may just be too great. I would hope that it's clear to the federal government now that they are going to have to get involved.

"In the meantime, we're being forced to deal with these states like so many little OPECs."

City of Breckenridge,
Office of Mayor,
Breckenridge, Minn., April 13, 1981.

Dear Honorable Members of the House Taxes Committee:

Enclosed please find a copy of the telegram sent to Chairman Irvin Anderson of the House Taxes Committee.

We would appreciate any help or consideration in getting a hearing on the Five Year Property Tax Moratorium bill.

Sincerely,

Ralph H. Possehl, Mayor.

Enclosure.

[Telegram]

We need your help! The Five Year Tax abatement is in your committee and we need your help to get it out of committee and before the Legislature so that some action can be taken.

In seeking your help, I am speaking not only for myself but for all of the Citizens of the City of Breckenridge. We are a border community and have used all of the means possible to try and compete with North Dakota, our neighbors to the west, in trying to not only get new business but to try and maintain our present businesses. We do not have the tools necessary to be competitive. Five Year Tax Abatement would at least give us some help.

I could go on and on, citing examples of the hardship of border communities such as: Population decline compared to growth in North Dakota; loss of children in our school systems; loss of Tax Base because we are losing new and existing businesses; increased tax burdens on the Citizens who remain in our City; and Loss of Revenue to the State of Minnesota.

When you live on the border and see companies such as 3-M and Min-Dak Sugar Beet Co-op constructing multi-million dollar facilities in North Dakota instead of Minnesota because of the tax advantages you begin to wonder if we even are a part of the State. We have always been proud to be a part of Minnesota and hope we can continue this feeling. With your help and consideration we can and will.

Sincerely,

M. D. Casper, *City Clerk-Administrator.*

City of Breckenridge,
Office of Mayor,
Breckenridge, Minn., March 2, 1981.

Gentlemen:

Enclosed are several articles which will substantiate the testimony that I have presented today, March 2, 1981, to the Senate Taxes and Tax Laws Committee regarding Senate File 356.

I hope you will review this information and give it your utmost attention. Also, I would like to request that you would please keep me advised regarding these border cities problems.

Sincerely,

Ralph H. Possehl, *Mayor.*

Enclosure.

North Dakota Business and
Industrial Development Department,
Bismarck, N. Dak., December 3, 1979.

Mr. David J. Hopkins,
Senior Vice President, I. S. Joseph Co.,
Minneapolis, Minn.

Dear Dave: Realizing that you are still in the process of selecting the most suitable site for your sunflower crushing facility I have put together some information which might be helpful in your considerations. From our conversations and also from news articles I understand that you are considering sites in both North Dakota and Minnesota and therefore I have put together a quick comparison of tax liabilities for these two states. As you will note in this comparison I have selected Enderlin and Breckenridge to use as examples. This comparison should be representative for any location in either North Dakota or Minnesota. As you will note there is a significant property tax difference between the two locations particularly when you take into account that in North Dakota you could receive a five-year property tax exemption. Both Cargill and the Sunflower Cooperative were granted this exemption and therefore I am confident that you could also obtain that same exemption.

Similarly to the property tax situation, you will also find a significant difference in the corporate income taxes of the two states. Two hypothetical examples which illustrate this have also been enclosed.

Again, I want to reiterate our sincere desire to accommodate you in order to make North Dakota the most propitious site for the location of your sunflower processing plant.

Best personal regards,

Myron G. Nelson,
Industrial Development Specialist.

Enclosure.

AN ESTIMATION OF TAX SAVINGS ON REAL PROPERTY IN NORTH DAKOTA VERSUS A MINNESOTA LOCATION

	Enderlin	Breckenridge	Wilken County
Market value of plant and equipment	$25,000,000	$25,000,000	$25,000,000
Assessment ratio (percent)	×0.17	×0.80	×0.80
Assessed value	$4,250,000	$20,000,000	$20,000,000
Tax factor (percent)	×0.50	×0.43	×0.43
Taxable value	$2,125,000	$8,600,000	$8,600,000
Mill levy	×266.24	×112.28	×77.8
Yearly tax liability	$565,760.00	$965,608.00	$669,080.00
5-yr property tax liability	×5	×5	×5
	$2,828,800	$4,828,040	$3,345,400
Savings with 5 yr tax exemption	$2,828,800	[1]	[1]
Net tax liability on real property for 1st 5 yr of operation	0	$4,828,040	$3,345,400

[1] No tax exemption available.

CITY OF BRECKENRIDGE,
OFFICE OF MAYOR,
Breckenridge, Minn.

To: Hon. Gov. Al Quie.

From: City of Breckenridge—Ralph H. Possehl, Mayor; Michael D. Casper, City Clerk-Treasurer; Kal Michels, Chamber of Commerce; Marvin Anderson, President—Breckenridge Industrial Development Corporation; Bob Hertzenberg, President—First National Bank, Member—BIDC Board of Directors; Tim Fox, Member—BIDC Board of Directors; Robert and Jay Schuler, SIGCO, Inc., (Sunflower Research and Development Company); and Laurie Sarkipato, Planning Coordinator—West Central Regional Development Commission.

Subject: Business Climate and Quality of Life Concerns in Breckenridge, Minnesota.

BACKGROUND AND ISSUES

During the past ten (10) years, the City of Breckenridge has faced severe economic and social problems caused by its location on the Minnesota-North Dakota border adjacent to Wahpeton, North Dakota. In the past two (2) years these problems have reached crisis proportion, and threatened the economic and social viability of the City. The main cause of these problems are the business and individual tax laws of the State of Minnesota. These problems are compounded by the City's topography and geographic location.

In the past five (5) years, 22 percent of the private sector employment (or 29 businesses) have left the City of Breckenridge. This phenomenon has caused the following detrimental effects on the City:

(a) There has been a population loss of approximately 577 people, the majority have gone to Wahpeton, North Dakota for personal income- and business-tax reasons.

(b) The School District lost approximately $200,000 School Foundation Aides from 1977–79. (200 children at $1,000 per child)

(c) The downtown area of the City is rapidly obtaining a "ghost town" profile, thus seriously discouraging business expansion, relocation, and/or rehabilitation efforts.

(d) With the population loss of working people and children, the population of Breckenridge is becoming more elderly (estimated 24 percent aged 65 and over population in 1975). These elderly people are generally not able to afford the cost of needed residential public improvement (streets, sewer, water, curb and gutter, etc.). Thus, Breckenridge's residential areas are obtaining a shoddy appearance. (Please see Part I of Appendix for further documentation.)

CITY OF BRECKENRIDGE EMPLOYMENT FIGURES

Type of establishment	Employees, Apr. 20, 1979	Percent
Private businesses	623	47.2
Public businesses	696	52.8
Schools	138	
City	43	
County	88	
Medical and dental	415	
Other	12	
Total	1,319	100.0

Note: Lost 175 employees or 22 percent of private employment base. 175 times 3.3 persons per household equals 577 population loss. $200,000 lost in foundation aids (approximate).

Source: Breckenridge Chamber of Commerce, 1979.

Recent changes in the retail and service sector of Breckenridge 1977–79 [1]

Name	*Employees*
Moved to Wahpeton:	
Rick's Electric	50
Daily News Printing	50
Twin Town Traders	4
Pamida-Gibson	60
Hager Shoe Store	3
Total	163
Moved to other locations (or closed):	
Union 76 Truck Stop	10
Bunny Bread	2
Siemer's Thrifty Service	3
The Lunch Box	3
The Iron Horse	15
Quick Stop Drive In	10
Folin Shoe Repair	1
Stratford Cafe	6
Stratford Hotel	4
Wards Auto Repair	3
Nordahl Jewelers	3
Jim's OK Hardware	3
Style-ette Beauty	3
Erickson Plumbing	5
Texaco Gas Station	5
Pic-A-Pop	2
Marv's Lockers	3
Micke's Fairway	4
H & R Block	1
Breckenridge Electric	2
National T Food Store	20
Big Burger Restaurant	15
Rosenblatt's	55
Red River Jobbing	5
Total	183
Grand total	346

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[1] Businesses that have moved out of the community.

Source: Breckenridge Clerk/Treasurer.

NO SUNFLOWER PLANT FOR BRECK

Following a press conference in Fargo this morning (Monday) Breckenridge has apparently lost its bid for a major sunflower processing plant.

Breckenridge city officials have been working with representatives from the I. S. Joseph Company, Minneapolis, in hopes of having the company locate here.

At the press conference this morning, Chairman of the I. S. Joseph Board of Directors, Burton Joseph, said Minnesota has lost out. He said I. S. Joseph will build a plant, but it will be in North Dakota

Joseph said North Dakota has a more favorable tax climate. He added that the main reason the company is choosing North Dakota is the company wanted its plant near a major source of sun seeds and North Dakota fills the need better than Minnesota.

Joseph, when quizzed, said Enderlin, N.D. is a possible site, but that it's not the only community under consideration.

He said a final decision will be made in 10 days to two weeks.

Breckenridge Mayor Ralph Possehl said, when contacted about the announcement, that city officials had known of the possibility the plant would not locate here for approximately two weeks but had agreed not to announce anything until a final decision had been made by the company.

Despite the company's decision, the city hopes to retain a $4.5 million federal loan promised the city by the Department of Housing and Urban Development should the I. S. Joseph Company locate in the city.

Negotiations are currently underway with another major sunflower processing company which is considering locating in the area.

The grant would be used as a loan to the new company should it decide to build here, Possehl said.

CITY OF BRECKENRIDGE,
OFFICE OF MAYOR,
Breckenridge, Minn., December 4, 1980.

GOV. ALBERT H. QUIE,
130 State Capitol,
St. Paul, Minn.

DEAR GOVERNOR QUIE: Enclosed please note the article regarding North Dakota's attempt to torpedo the City of Breckenridge's and State of Minnesota's plans to work with the I. S. Joseph Company, Inc. in building the said sunflower processing plant in Breckenridge through the use of our meager State incentives and with the help of our UDAG Grant.

It seems every attempt made by the City of Breckenridge and other border cities to bring one of these companies to our State to build plant and employ people is met by North Dakota's tax abatement policies.

I am sending a copy of this to Mr. Clyde Allen, Commissioner, Department of Revenue and Mr. Kent Eklund, Commissioner, Department of Economic Development again in an attempt to get some sort of help from our State government to combat this ever increasing policy of the State of North Dakota. This problem, along with the terrible problem on the difference in Workmen's Compensation in the two states, is taking the State of Minnesota completely out of competition for these commercial and industrial developments.

Would greatly appreciate hearing from your office concerning these problems.

Sincerely,

RALPH H. POSSEHL, *Mayor.*

Enclosure.

SUNFLOWER PLANT GIVEN 5-YEAR TAX ABATEMENT

ENDERLIN, N. DAK.—The North Dakota State Tax Equalization Board has given approval to National Sun Industries for the construction of a sunflower processing plant here.

The plan would allow the firm a five-year abatement on property as well as income tax pending its final decision to locate in Enderlin.

The state board, composed of Gov. Arthur Link, Agriculture Commissioner Myron Just, Auditor Bob Peterson and State Treasurer Bob Hanson, gave unanimous approval for both tax abatements at a recent meeting.

Attending the session were Charles Feeney, president of the Enderlin Development Corp.; Mayor Morgan Fraase, Ransom County Commissioners Ernie Fadness and Francis Archbold, and Jim Huseth of I.S. Joseph Co., one of the firms forming Sun Industries.

This week representatives of the I.S. Joseph Co. and Samuel Muller of Universal Seed and Oil Co., the other firm forming Sun Industries, met with community leaders and county officials to look over the proposed site.

ATTACHMENTS SUBMITTED BY MR. KIRKHAM

(Attachment A)

COAL SEVERANCE TAXES

Whereas, the nation has grown dangerously dependent on imported oil and in recognition of that dependence the Congress has passed several laws relating to the conversion of electric utilities from oil and gas to coal, and

Whereas, the increase in coal production required by such conversion efforts will result in costs to coal-producing States which should be recompensed, and

Whereas, some coal-producing States have taken advantage of the growing national need for coal through the imposition of unreasonable coal severence taxes, thus imposing inequitable burdens on electric consumers, and

Whereas, H.R. 6625 and H.R. 6654 impose a maximum limit of 12½ percent on severance taxes on coal, which will produce sufficient revenues to meet coal-producing States' costs and is consistent with previously enunciated APPA policy;

Now, therefore, be it resolved: That the American Public Power Association reaffirms its previously announced position in opposition to extreme State severance taxes and supports the enactment of H.R. 6625 and H.R. 6654.[1]

Adopted by the American Public Power Association's Legislative and Resolutions Committee at a meeting on May 6, 1980 in Washington, D.C.

(Attachment B)

[From Public Power, November–December 1980]

SHOULD UNITED STATES LIMIT STATE SEVERANCE TAXES—YES

(By Mayor Don Fraser)

No issue in recent years has troubled Congress and the American public more deeply than our national energy crisis. Following the Organization of Petroleum Exporting Countries (OPEC) embargo in 1973, oil and gas prices have escalated at unprecedented rates. This situation, combined with the inability of American petroleum producers to keep pace with the nation's demand, has made us dangerously dependent on foreign oil imports.

In order to reduce this unhealthy dependence and become energy independent, we have established a national policy in favor of converting to our most abundant natural resource—coal. Two states, however—Montana and Wyoming—are taking advantage of our national energy crisis by imposing excessive severance taxes on coal mined within their borders. Montana now imposes a whopping 30 percent severance tax; Wyoming imposes a combined severance, excise and ad valorem tax of 17 percent. These severance tax levels are not only in direct conflict with our national policy in favor of encouraging and mandating coal consumption, they are flagrantly inequitable.

(Severance taxes are generally referred to as ad valorem taxes because they are imposed on the value of goods or services as that value is measured by price. Thus it is the cost per ton of coal produced upon which these excessive severance taxes are levied.

(Efforts have been made to compare the Wyoming and Montana tax levels with tax levels imposed on other fuel sources such as oil and natural gas on the basis of Btus. This is a faulty comparison. Btus are not units of value; they are units of energy.

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[1] Identical to H.R. 1313 and S. 178 introduced in the 97th Congress.

(Moreover, different energy sources such as coal, gas and oil do not have interchangeable uses (e.g., you cannot put coal in your car). Therefore Btus are not interchangeable. Therefore, they are not appropriate units of comparison for measuring severance taxes.)

12.5 Ceiling proposed

Legislation considered by the Congress would remedy this unfair situation by imposing a 12.5 percent limitation on coal severance taxes. It has attracted strong, broad-based, national support and a non-partisan coalition of congressional cosponsors.

H.R. 6625 and H.R. 6654, identical bills which would place a 12.5 percent limitation on taxes on coal shipped into interstate commerce, are co-sponsored by 79 members of the House of Representatives. Hearings were held before the Subcommittee on Energy and Power on March 21 and June 5. On Sept. 4 this legislation was advanced to the full Committee on Interstate and Foreign Commerce which approved the bill, 15 to 9, on September 16.

The Senate version, S. 2695 (which has 12 cosponsors), places a 12.5 percent limitation on state severance taxes on coal produced from federal and Indian lands. Hearings on it were held by the Senate Energy Committee on Aug. 6.

The following facts place the issue in the proper perspective and overwhelmingly support the need for remedial legislation:

Our nation's energy policy mandates that electric utilities convert to coal. They have no choice.

The bulk of America's low-sulfur coal is located in a few western states. Montana and Wyoming hold 40 percent of all U.S. coal reserves and 68 percent of the low-sulfur coal reserves.

About three-fourths of this coal is found on federal lands—owned by all Americans.

Montana's 30 percent severance tax and Wyoming's 17 percent severance tax are significantly higher than the coal severance taxes imposed by other coal-producing states. (For example, Oklahoma charges 5 cents per ton and Kentucky charges 4.5 percent of the gross value. The severance taxes imposed by Montana and Wyoming translate to tax rates as high as $4.48 per ton.)

The Wyoming and Montana severance tax rates were raised to their current levels after the focus of our national energy policy was directed toward low-sulfur coal. (Prior to 1975, Montana's tax was only 34 cents per ton.)

DOE projections substantiate a 95 percent increase in coal consumption for electrical generation in the next five years. By 1990 more than 35 percent of our nation's coal needs will be supplied by Montana and Wyoming.

By 1987, electricity consumers in 27 states will be paying $360 million each year in western coal severance taxes alone.

NERA says 2 cents/ton fair

The Montana 30 percent tax and the Wyoming 17 percent tax are many times higher than what is necessary to cover state costs incurred to support coal production. According to the National Economic Research Associates (NERA), which conducted an exhaustive examination of impact costs of coal production in Montana, two cents per ton is a fair estimate of the cost that coal mining imposes on local governmental bodies—including schools, hospitals, police, fire, sewage, recreation, welfare, libraries, and general government. Additional costs, including environmental, to the state and others add four cents to each ton. Thus, NERA estimates that a severance tax of six cents per ton, or 1.5 percent of value, is sufficient to cover legitimate state coal production costs.

The figures quoted by NERA are consistent with a report recently released by the Congressional Budget Office (CBO). Using costs which would result in a "worst case situation," the CBO estimates support the conclusion that a 3 to 4 percent severance tax in Montana and Wyoming would be sufficient.

This same report substantiates that revenues from coal production in Montana and Wyoming will far exceed related costs: Wyoming's 1980 surplus of $15.7 million will increase to $328.2 million by 1980; and Montana's 1980 surplus of $5.1 million will increase to $84.8 million by 1990. Obviously, the 12.5 percent figure contained in H.R. 6625, H.R. 6654 and S. 2695 is more than generous to these states.

Additionally, generous federal funds from several sources are available to offset potential deleterious effects of mineral production. Under the Mineral Leasing Act of 1920, as amended, a full 50 percent of the 12.5 percent federal royalty on coal goes directly back to the producing states. Another 40 percent of the royalty is placed in a reclamation fund which is used for water projects in western states. The Fuel Use Act of 1978 authorized additional federal impact aid for coal-production areas, and the Surface Mining Control and Reclamation Act of 1977 levies a 35 cents tax on each ton of strip-mined coal. Fifty percent of this figure is returned directly to the state for reclaiming strip-mined land. Surplus revenues received from this fund may be used for socioeconomic impact costs. Moreover, the same Federal Reclamation Act and state reclamation laws in Montana and Wyoming—among the strictest in the nation—require that all reclamation costs be borne by coal producers, rather than the states.

A brief look at where Montana has allocated its coal tax dollars is an eye-opener:

Fund	Fiscal year—		
	1979	1980	1981
Trust fund (50 percent beginning in 1980)	$10,700,000	$23,600,000	$40,300,000
Alternative energy grants	800,000	1,500,000	2,000,000
Local impact	5,400,000	9,000,000	7,100,000
Education trust	3,100,000	8,900,000	8,000,000
State equalization aid (State school foundation)	3,200,000	5,200,000	4,000,000
County land planning	300,000	500,045	400,000
Renewable resources	800,000	1,300,000	1,000,000
Parks and cultural projects	8,000,000	2,200,000	2,000,000
State libraries	0	400,000	400,000

The figures speak for themselves, particularly the 50 percent of total severance tax revenues allocated by law to the trust fund—$40.3 million as compared with only $7.1 million for local impact in fiscal 1981. Montana clearly does not intend to use its severance tax dollars to alleviate the actual impact of coal production. Rather, these millions of dollars are being stashed away in a trust fund which, by law, requires a three-fourths vote of the state legislature to touch the principal.

The impact of the excessive taxes being levied on coal by Montana and Wyoming cannot be overstated. Twenty-seven states will soon be consuming coal produced in these two states. The coal severance taxes collected by Montana and Wyoming from these 27 states are expected to reach $360 million annually by 1987. In my own state of Minnesota alone, consumers paid approximately $16.5 million in western coal severance taxes in 1979.

Since fuel costs, including these severance taxes, are passed directly on to bill-paying consumers who have no voice in the tax level imposed by these producing states, it is the citizenry of the 27 consuming states who are bearing the unfair burden imposed by Wyoming and Montana.

Montana, Wyoming "Gouging"

The 12.5 percent limitation contained in legislation currently pending before the U.S. House of Representatives and the U.S. Senate provides a more-than-sufficient compensation to the states of Montana and Wyoming for their coal production costs. Simply stated, Montana and Wyoming are gouging the energy-consuming states to the detriment of our national energy policy.

Opponents of badly needed remedial legislation have sought to obscure this fundamental fact by charging that a federal limitation on the rising tide of state severance taxes is an unprecedented intrusion on states' rights. In fact, the very opposite is true. The federal government has in the past stepped in to impose tax limitations in those few instances where states have stretched their taxing powers to abusive levels which threaten interstate commerce. In 1973 Congress passed the Airport Development Acceleration Act, a program intended to stimulate the growth of U.S. air transportation. One provision included in this program was a prohibition on state imposition of taxes or fees on persons traveling by air. This prohibition was the result of a congressional finding that such taxes "inhibit the growth of the air transportation system." Its constitutionality has been upheld in the courts.

In 1975, Congress enacted the Securities Acts Amendments of 1975, which included a prohibition of state taxation on certain transfers of stock through a registered agent with facilities in the state. This provision reflected testimony before the Senate Banking Committee "that the imposition of state transfer taxes may be impeding the development of a national system of processing securities transactions." Its constitutionality is also beyond question.

By enacting hitherto unheard-of coal severance tax rates, Montana and Wyoming have acted in unprecedented fashion and made it imperative that the

Congress intervene. They have started a trend toward bidding up coal severance taxes with no end in sight.

In 1975, when the Montana legislature passed the 30 percent tax, Wyoming's coal taxes were about 7 percent. They now total 17 percent and Wyoming Gov. Ed Herschler has twice attempted to add five more percentage points to Wyoming's tax. South Dakota's tax has grown steadily to an effective rate of about 20 percent. And New Mexico recently raised its coal severance tax for the third time in the last three years.

If the Congress does not restrain this process, coal severance taxes will continue to escalate to even more dangerous levels and continue to balkanize our nation's progress toward the implementation of a coherent and workable national energy policy.

SHOULD UNITED STATES LIMIT STATE SEVERANCE TAXES—NO

(By State Senator Thomas Towe)

Utility companies buying Montana coal have persuaded a number of congressmen and senators to urge a limit of less than 10 percent (12.5 percent after reduction by taxes) on severance taxes collected by state and local governments. Under the thinly veiled guise of "consumer legislation" they have introduced legislation limiting the amount of coal taxes Montana and Wyoming can collect. The Montana and Wyoming taxes actually amount to 22.5 percent and 13 percent respectively. That is because all federal state and local taxes are allowed as deductions before applying the statutory 30 percent and 17 percent rates.

The proposed federal limit is a cruel hoax. It has been, I submit, foisted onto Congress by the investor-owned utility companies who see an opportunity of gaining millions of dollars to split between themselves and the coal companies by avoiding the true costs of coal production.

The complicated long-term contracts between the Midwestern utility companies and their coal company suppliers would act as a very convenient shield to prevent any consumer from ever benefiting from such legislation. Utility companies have spent more than $800,000 so far this year lobbying for passage of this legislation.

The facade of justification for such legislation can be maintained only if proponents can establish that Montana and Wyoming are collecting more revenue from coal development than actual government costs. There is no factual basis or independent research for making such an assumption. Yet without it the proposed legislation amounts to nothing more than the economic exploitation of one part of our great nation by another part.

Montana exploited

While mining companies extract millions of dollars of mineral wealth, much of which belongs to the public domain, for their own private profit, what happens above the ground is frequently of little or no concern to them. The huge wealth taken out of the "richest hill on earth" at Butte, Mont., did not stay in Montana. It went to corporate headquarters and bankers in New York City, to the Corcoran Art Gallery in Washington, D.C., and to the University of Virginia and Stanford University.

The people and taxpayers of Montana were left with:

(1) the supervision of reclaiming one of the largest open pits in the world—a pit which has engulfed a good part of downtown Butte; and

(2) a gigantic urban renewal problem, namely, what to do about a decaying city of 23,000 people that once had a population of more than 100,000.

With the advent of coal development in eastern Montana, the people of Montana are determined this exploitation of their wealth without any provision for the problems of the future shall not happen again.

Would anyone seriously deny that large companies, particularly mining companies, have never been required to pay the full costs of government services demanded by their employees and by their development? One need only look at the impoverished areas of coal-rich Appalachia.

Although everyone expects a full line of government services such as law enforcement, fire protection, city water, city sewer, streets, roads and good schools, no one seems to connect these enormous costs with that which caused them, namely, the mining or other development that brought in all of the people. This situation is particularly aggravated where mining takes place at least 50 of 60 miles from the nearest town or shopping community.

Assess true costs

In Montana, and to a lesser extent in Wyoming and North Dakota, the people are determined to put the true costs of government services on the very people who benefit from exploiting the natural resources. Additionally, in each state a provision is made to take care of the problems of the future to prevent more Butte situations. The method: a severance tax that is paid by the coal companies and eventually the consumers who are able to obtain cheap power because of the unusually low cost of western coal. Perhaps for the first time ever, large coal companies are required to pay their full way.

Let us look at some specific costs.

Although coal companies must do their own reclamation work at their own expense, some costs are associated with the administration of the laws governing the coal mines. For example, in Montana the Strip Mine Coal Conservation Act, the Strip and Underground Mine Siting Act, the Montana Strip and Underground Reclamation Act, the Plant Siting Act, the Water Quality Act, and the Air Quality Act all must be administered by state government. Each mining company application must be reviewed not only for reclamation plans but also to determine whether the particular land is too environmentally fragile or has important archeological or historical significance and should not be mined at all. To date not a single acre of Montana mined land has been released from its reclamation bond.

Although Montana receives some assistance from the federal Strip Mine Reclamation Act, the total budget for enforcement of all mine regulatory laws and environmental laws that affect coal was approximately $7.5 million per year during the last biennium. This is more than one-half of the amount of severance taxes Montana sets aside for the general costs of government ($12.8 million went to the general fund in fiscal 1979). Considering the size of coal companies' operations, $12.8 million (19 percent of total coal tax revenues in 1980 and thereafter) is not a large sum of money for them to contribute to the general cost of state government.

Impact funds inadequate

Of far greater significance is the impact cost. Over the first four years of our experience with the coal tax we set aside more than 27 percent of the total revenues ($37.5 million) for this purpose. Unfortunately this has not been sufficient. The costs of providing government services to the impacted areas is enormous.

In Montana most of the impact portion of the coal tax revenue is administered by the Montana Coal Board. It receives applications from local governmental units for impact assistance. During the May 1980 meeting of the Montana Coal Board, it received requests totaling $28.8 million. The board had but $3.3 million available at that meeting, and only $6.5 million available for the entire year. Obviously its decisions are based not on need but on available funds.

The Montana experience is not unique. The North Dakota Regional Environmental Assessment Program (REAP) conducted a $4 million study of impacts in North Dakota. Based on what it termed "modified level one development," the rate of development that seems most realistic, North Dakota will be $10 million short of meeting all impacts over the seven-year period covered by the study—even if all coal tax revenues are devoted to impacts, leaving nothing for the future.

Similarly, a recent report by the Old West Regional Commission, comprised of the states most affected by coal development, identified capital needs in 12 Wyoming counties due to coal development and determined they would have a $27.6 million shortfall over the next five years, despite using all available federal, state and local funds to meet these impacts.

Furthermore, most all studies and all Montana Coal Board actions have failed to take into account some of the social problems associated with coal development. For example, studies show that a more transient population tends to have greater need for alcoholism services, mental health services and similar social services.

These social costs are immeasurable. Wally McRae, who ranches near Colstrip, stated that problem well:

"What is the cost to my children who attend a school where 70 percent of the students have used drugs in one form or another? What is the cost of having 23,700 tons of sulfur dioxide per year dumped on our agricultural lands from Colstrip plants 1 and 2?"

Road costs ignored

Finally, roads are perhaps the most costly of impacts. The strain on the existing road system and weekend shoppers has been enormous. Montana identified $64 million in road work that was required in the impacted area and has saved only $15 million for this purpose to date. At present we are not meeting the real needs of the people affected by coal development.

Most studies, including one by the Congressional Budget Office, have completely ignored the cost of roads. The study conducted by National Economic Research Associates (NERA) at the request of the utility companies, to support their position that 12½ percent is a sufficient coal tax rate, is woefully inadequate.

Not only did it ignore roads. NERA also ignored mine construction employment, plant construction, plant operation and the enormous impacts of synfuel plants. The errors are compounded by lack of understanding of Montana employment and geography and of capital need in impacted communities. Unemployed lumber workers in western Montana are unlikely to commute 350 miles to strip coal in eastern Montana. The capital investment in a rapidly growing community whose fortunes are likely to shift cannot be amortized over the usual 20-year period. The investment must be amortized in from three to five years.

I submit that everyone, including those of us who introduced and supported the coal tax bill in Montana, have underestimated the cost of impacts. One needs only contemplate the enormous costs that could come to Montana if we were to receive but one of the 30 synfuel plants scheduled for this country by 1992 in the administration's synfuel program. Just one plant in a remote area could bring an influx of 25,000 people. This would make the community the fourth largest city in our state.

There are presently four applications pending for preliminary funding for synfuel plants in Montana. The cost of government services to provide what will undoubtedly be demanded under these circumstances should be apparent. There is no way Montana or Wyoming could handle this situation if any of the current bills limiting our coal tax passes Congress.

To date federal assistance has been a joke. Assistance from Section 601 of the Federal Impact Assistance Act amounted to $286,000 in fiscal 1979 and $1,080,000 in fiscal 1980. Additionally we received $555,000 from our one-half of federal royalty income in 1979. Our coal board spends nearly 10 times that amount each year.

Trust fund essential

And there are future costs. We must still accept on faith the fact that our semiarid lands can be fully reclaimed. We expect that they can be, but it will take much longer than originally thought—maybe 15 years.

Further, we still do not know the total impacts of the loss of groundwater in the coal fields. Vital to agriculture in eastern Montana, it may be lost forever. Removal of the coal "floor" may sweep away underground water that has sustained the farming and livestock industry.

We must also plan for the time when the coal is gone and the mining moves either to another area or leaves the state altogether. There will be tail-end impacts, such as school bonds and city bonds that remain unpaid. The economic dislocation of employees will be significant. The decay of the mining towns will bring additional costs to those communities which they will be unable to meet.

Future problems must be provided for now while revenue is available. We have tried to provide for these costs by setting aside a substantial portion of the coal taxes (50 percent in 1980 and thereafter) in a permanent trust fund which will always be available in the event future problems require additional funds. We look at that trust fund as the only thing that stands between us and our becoming an impoverished area when the coal is gone, as has happened to so many other coal-producing communities.

Tax used responsibly

Other uses of our coal tax include an alternative energy research and demonstration program, a renewable resource program, education, park acquisition and maintenance, and a very small portion for historic preservation, culture, and libraries. No part of our coal tax goes directly for tax relief (unlike Alaska's oil severance tax or Minnesota's taconite severance tax).

There are other arguments that can be advanced in opposition to any attempt to limit severance taxes on coal.

First, it is unprecedented. Federal power has not previously been used to limit a state's general taxing authority.

Second, unlike most Appalachian coal-producing states, neither Wyoming nor Montana collects a property tax on coal while it is still in the ground. We wait to collect our tax until the coal is extracted and the quantity and value can be more easily determined. By necessity, therefore, the tax must be higher.

Third, the burden of Montana's coal tax on the ultimate consumer is negligible. Assuming it is all passed onto the Midwestern or Southern electrical customer it amounts to an average of less than 1 percent of the ultimate utility bill (2 percent if only western coal is used by the utility company). By contrast all Midwestern states that use Montana coal have a sales tax of between 3 percent and 9 percent on the electricity generated from the same coal.

Fourth, the bills single out two states for punitive action while at least seven other states which are collecting far more money in severance taxes remain unscathed. For example, Texas collects 20 times more revenue on oil than Montana collects on coal.

Fifth, when reduced to the only fair common denominator, Btus, Montana compares very favorably with oil severance taxes per million Btus in Texas (8.84¢); New Mexico (10.76¢); Oklahoma (12.58¢); and Louisiana (16.58¢). In cents per million Btus our tax (9.97¢) is lower than three of those four states' severance tax on oil.

Sixth, the effect of the bills could be avoided by levying a property tax on coal in the ground as most Appalachian states do, by levying a business and occupation tax as West Virginia does, and by burning all of the coal at the mine mouth as North Dakota does.

Dangerous precedent

Congress probably does have the power to limit our coal severance taxes. To exercise such power would be extremely unwise. Not only would it allow other states to exploit natural resource without paying full costs of that exploitation (colonialism) but it would set an extremely dangerous precedent.

If Congress can reduce the tax on coal to produce cheaper energy for the rest of the nation, it can also limit the tax on oil to produce cheaper gasoline, limit the tax on taconite to produce cheaper steel products, limit the the tax on timber to produce cheaper lumber products, and could even limit Michigan's single business tax to make cheaper automobiles for the rest of the nation.

Congress has not ventured into this field in the past. I think it would be extremely unwise to do so now.

Senator **Durenberger**. Our next witness is the originator of the coal limitation bill—now a chief cosponsor—the senior Senator from the great State of Arkansas, Senator Dale Bumpers.

Dale, thank you very much for coming to the hearing this morning. We look forward to your testimony.

TESTIMONY OF HON. DALE BUMPERS, U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator **Bumpers**. Mr. Chairman, thank you. I hope I did not inconvenience you. I hope you are in a lag here. I understand it would have been another 5 minutes before I could have testified.

But in any event, let me first thank you for taking over the burden of carrying the ball on this bill which I introduced in 1980. I certainly am happy to be a cosponsor of the legislation with you.

I hope I didn't frighten anybody with that 17-page statement. I will just summarize the statement, Mr. Chairman, and ask that the full formal statement be inserted in the record.

It is difficult to talk about this subject without stepping on the toes of dear friends from the States of Montana and Wyoming. Maybe that is just one of the hazards of this kind of legislation which we will have to bear.

Certainly you and I have the highest regard for the representatives here in the Senate from those States, and the highest regard for the people of those States. However, we have to look at the realities and at the effect of these severance taxes on our country and our energy policy.

Considering the exponential price increases in the price of oil that we have been experiencing in this country and particularly since the President's decision to decontrol oil in the next 10 years. Decontrol of oil is going to add $128 billion to the coffers of producing States, and 83 percent to that $128 billion, or $106 billion, is going to just four States—that is, Alaska, California, Texas and Louisiana. Again, I don't want to single out particular States for criticism. However, I have seen statistics, correct or not, that Alaska can and is indeed in the process of abolishing all taxes. I understand that she can abolish all taxes, increase her $1.3 billion annual budget by 12 percent, give substantial rebates to every person in Alaska, and still have a $20 billion surplus in the year 2000. Mr. Chairman, you know who is going to pay that. It is the people in the lower 48.

Well, this is actually becoming contagious, and that contagiousness is spreading to other States in the form of severance taxes on coal. It is simply going to polarize this country to an unacceptable level between those very, very few States who happen to be blessed with energy and the roughly 44 States who do not, mine and yours being in the have-not column.

Wyoming and Montana have 40 percent of this Nation's coal reserves. We have continued to believe that that was our ace in the hole, which indeed it is. When push comes to shove, this Nation will survive for the next century or two just because of those tremendous coal reserves.

Montana and Wyoming have 40 percent of this country's coal, but 75 percent of it is owned by the Federal Government. Who is that? That is the 225 million people of America. That is who the 40 percent of this country's coal reserves belong to, not to those two States alone.

As you know, of course, our bill only goes to Federal coal. I think it ought to go further than that, but I am not going to belabor that point now.

These States can determine this country's energy policy. They can determine our coal policy for certain. They can determine whether or not we are going to survive with our energy policy; and, if we are going to survive, what it is going to cost and essentially who is going to pay for it.

You know that Wyoming now has a 17-percent severance tax. So I don't get called on the carpet by members of that delegation, I must say that I know some of that percentage is a county ad valorem tax. But the fact is that the total is 17 percent, and for consuming States that bottom figure is what counts. Montana's severance tax is 30 percent.

Any State is entitled to be compensated for whatever economic, social or cultural impact they sustain as a result of massive exploitation of energy resources within their States. It is a mixed blessing for Montana and Wyoming to have all of this coal under the ground. However, the question we are really groping with is "How much is enough?" If those States didn't have model reclamation laws, maybe those excessive severance taxes would make sense.

The mined land must be put back to its original form as much as possible. The reclamation is being done by the coal companies. The State does not have to bear that burden.

I have more than just a national interest in this. I also have a parochial interest because, in 1985, four generating plants in my State will be burning Wyoming coal, 11 million tons of it to be precise. We are a small producing State. We produce less than a quarter-million tons a year, which is peanuts compared to the production you get in the big coal-producing States. Our State has a 2 cents a ton severance tax on coal. Every time I say 2 cents, the press reports that it is 2 percent. I wish it were 2 percent. It is 2 cents per ton. That means, on a $10 ton of coal, Wyoming gets $1.70 and Montana gets $3.

Every State ought to have the right to be compensated for whatever impact they sustain as a result of the taking of this energy. However, the coal-producing States get 50 percent of the royalties that the Federal Government gets on their coal. Most of the coal being mined out there right now admittedly is not Federal coal; however, they are going to be getting to that Federal coal. For every ton of Federal coal that comes out, the U.S. Government gets a 12½ percent royalty. They may get more, but that is the minimum that the Government can charge for its coal under law. The States of Wyoming and Montana will get half of that 12½ percent royalty. In addition to that, 40 percent of the remaining 50 percent, or 80 percent of the Government's share, goes into reclamation projects, most of which go to States in the West, like Wyoming and Montana. You can say 90 percent of the royalty that the U.S. Government receives is also going back to those States.

Then these States receive payments in lieu of taxes, which this administration may or may not be successful in torpedoing—they are planning on it.

Every time the Federal Government leases an oil and gas tract in Wyoming, the State of Wyoming gets 50 percent of that bonus and they also will get 50 percent of the royalties.

So you can see, Mr. Chairman, we are doing our very best to compensate those States in other ways, completely aside from these severance taxes.

As I said, I won't bore you with this long statement, but I do want to give you a calculation. In 1979, 32,340,000 tons of coal were mined in Montana, of which 12,900,000 tons were Federal—roughly one-third of it was Federal coal. In Wyoming, 71,825,000 tons were mined, of which 30.1 million tons were Federal.

If you assume coal sells for $10 a ton—and that is approximately correct—with Wyoming's severance tax of 17 percent, she would have gotten $21,930,000 severance tax off Federal coal. Montana, with a 30 percent severance tax, would have gotten $97,350,000 off Federal coal.

In addition to that, when you consider that the Federal Government got $1.25 or 12½ percent on that $10 ton of coal, the coal-producing States also got one-half of that—or roughly 62½ cents—on each ton of coal just because we give them one-half of our royalties on the mined coal. There has just got to be some limit placed on this.

As I said a moment ago, I have a parochial interest. In 1973 we had 35 utilities in 14 States using Montana and Wyoming coal. I think yours is probably one of them. That was in 1973. Today, Wyoming and Montana coal is being burned in utilities in 20 States. In 1987 Montana and Wyoming coal will be used in 68 utilities in 27 States.

In 1978, my State of Arkansas burned 1½ million tons of Wyoming coal. We have a long-term, 20-year contract to burn Wyoming coal. In 1978 we paid the State of Wyoming $2.1 million in severance taxes. In 1986, Mr. Chairman, we are going to burn between 11 and 13 million tons. We are going to spend—the poor State of Arkansas—for every family of four in the State, $40 in severance taxes to the State of Wyoming—or $20 million.

You know that Montana has already reduced its property taxes. This thing has reached the point, Mr. Chairman, that Texas and Louisiana are talking to Australia, South Africa, Poland, and China about importing coal to the United States.

I want to say one final thing. My staff has prepared a brief on the Supreme Court decision.[1] Based on the brief, I couldn't disagree with the decision more.

Mr. Justice White, who wrote the concurring opinion, said that the only way this could be resolved would be through Congress. Congress could enact our bill as a matter of national energy policy. I can tell you that you will see this country polarized, as never before since the Civil War, unless the Congress addresses this issue. I am quite frank to say that it should not just address it on the issue of Federal coal; it should address it on the issue of coal.

Finally, for the benefit of the record, as you know, our bill does not take everything away from Wyoming and Montana; it simply limits the severance tax they can collect to 12½ percent. Our bill is only limited to Federal coal. Twelve and one-half percent will still be, by far, the highest severance tax in the Nation. It is a very generous bill. But we have to live in the real world of political realities here. It is probably the best we can do. We will be very lucky to get that.

Mr. Chairman, again, I thank you for your interest in the legislation, for introducing it, for holding these hearings, and finally for permitting me to be here to testify.

Senator DURENBERGER. Thank you very much, Senator Bumpers.

On your last point we heard a substantial amount of testimony yesterday that related to the Supreme Court decision. One of the people who testified—I think it was probably Bill Rogers—indicated that on the issue of whether or not the Supreme Court had the capacity to deal with the issue of the reasonableness of the tax, they had been following Justice Blackmun's lead. He had been writing for the majority on a number of the cases which dealt with the reasonableness of State taxation as it relates to the interstate commerce clause.

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[1] Copy available from Senator Bumpers' personal office.

Obviously, it came as a surprise when Justice Blackmun ended up writing the minority opinion which pointed out why the Supreme Court, if they wanted to, could take on the issue of reasonableness. I asked him at the time whether or not he saw this as some radical change in the Court. He dodged the issue. Obviously, there is a concern here that the Supreme Court has asked the Congress—you know this better than I—apparently on several occasions, to deal with the issue of State taxation as it relates to interstate commerce. Only in a very few cases has the Congress taken on this issue.

You indicated that this is one which has a great tendency to polarize. Frankly, one of the reasons we are having this hearing on the severance tax in the Intergovernmental Relations Subcommittee rather than trying to push our way through the Energy Committee is because I think you and I both see this in the context of fiscal disparities. Some sort of political rearrangements are taking place in this country which are being, in effect, forced on this Nation—political relationships among the States and political relationships between the State and the Federal Government.

I wonder if you wouldn't just speak to the realities, and perhaps the necessity, in the Federal system context for this Congress to take on this issue and to do it as soon as possible.

Senator **Bumpers**. I am not sure just how to address that question.

As I stated in the beginning, I thought the Supreme Court decision was wrong.

We are talking about a severance tax on Federal coal. It was my belief that the case of *McCullough* v. *Maryland* settled that issue many years ago. The Court said that the power to tax a Federal entity is the power to destroy and they said it couldn't be done. Justice White in his concurring opinion in the *Montana* case said:

> This is a very troublesome case for me and I join the Court's opinion with considerable doubt and with the realization that Montana's levy on consumers in other States may in the long run prove to be an intolerable and unacceptable burden on commerce.

Incidentally, I don't, right now for the life of me, understand why they could not have addressed it on that basis. They sort of conceded in the decision. I know this: The tax goes far beyond the amount necessary to compensate the State of Wyoming for any burden that it is going to sustain as a result of taking the coal.

Justice White concludes:

> Yet Congress is so far content to let the matter rest and we are counseled by the executive branch through the Solicitor General not to overturn the Montana tax as inconsistent with either the commerce clause or Federal statutory policy in the field of energy or otherwise.
>
> The constitutional authority and the machinery to thwart efforts such as those of Montana if thought unacceptable are available to Congress and surely Montana and other similarly situated States do not have the political power to impose their will on the rest of the country.

As he presently sees it, therefore, the better part of valor is to respect the other branches of the Federal Government.

In the context that you have put it, it is going to be terribly destructive of the federalism concept.

Senator **Durenberger**. Let me talk about the reality of our proposal to put a 12½-percent limit on severance taxes on Federal coal.

Again, Bill Rogers yesterday said that he thought that would solve the problem of fiscal disparities and a lot of other problems. But you pointed out here today, when you talked about the four big States which were going to benefit substantially over the next few years from our purchases of energy across this country, they weren't coal-producing States. When you go to Montana, talk to them about coal taxes. They will talk right back to you about Texas and Louisiana, the States that you have mentioned. I just am not totally convinced that putting a 12½-percent severance tax limitation on coal from Federal lands is going to solve the problem. We have the rates on oil and gas which might bump up. We have the royalty problem which you pointed out so well, 90 percent of the 12½ percent stays right in the States. We have the payments in lieu of taxes problem.

That brings us to a whole other issue, the problems that are going on within these coal States between local governments and the State government. Malcolm Wallop pointed that out when he introduced a bill to get some more relief from the windfall profits tax. He said we ought to maintain this ad valorem approach because the severance tax approach wastes a lot of money.

It is a lot of bureaucracy, paperwork, to collect taxes from the State level. He was speaking at that time for the local governments. It is the local governments in all of these States that will fight elimination of the payments in lieu of taxes because that is one of their guarantees against the State—whatever that may mean—ripping them off.

You have pointed to a lot of the problems. I don't think either one of us would really pretend that a simple 12½-percent limitation on coal on Federal land is going to solve the problem of disparity.

Senator **Bumpers**. You are precisely correct. Although our bill affects a significant part of the coal reserves of this country—those owned by the Federal Government, frankly, I think that the legislation ought to be broadened to cover coal, period, as a part of our national energy policy.

The other point I would make is the right of local governments to raise taxes, as well as the State government. In Wyoming the State tax is 10.5 percent and the county tax is 6.5 percent. I can envision the State levying a 20-percent tax. There is no limit in the Supreme Court decision. The State and local governments are going to be vying with each other to see who can collect the most tax off this coal.

Senator **Durenberger**. You and I have to deal with a variety of pieces of the problem all the time. Before you arrived, I was asking another witness what do we do when the Secretary of the Interior gets through leasing offshore and comes onshore and starts the leasing process. There is a very small amount of Federal coal lands in leases so far. A tremendous amount remains out there.

When he gets through offshore, he comes onshore with a deal where we give away 90 percent of it now It seems to me that you and I and a lot of other people will have to stand up and say, "Hey, in the interest of 225 million people, the sale of their resources ought to, in some way, recapture for them some of the high costs of energy in this country." So right off the bat, we have to deal with a piece of this problem.

Alaska's severance tax on oil is 12¼ percent. It all comes from State lands since they were wise enough, as you know, to have the opportunity to pick and choose even though they didn't really, at least last year, take much credit for that wisdom. It all comes from State lands. So, they take another 12½ percent as a royalty. Then, they have a corporate income tax on oil companies, and somehow or other the windfall profits tax is not a deduction. Maybe we just can't deal with Alaska. Maybe that is a phenomenon.

Senator **Bumpers**. It is a separate issue. Yet it is sort of similar. I said one time—I am not even going to repeat it, I regret having said it. [Laughter.]

Senator **Durenberger**. You have already repeated a few things.

Senator **Bumpers**. Let me put it this way. The OPEC cartel taught us a lot about how to rip people off. Coal ultimately, of course, is going to be tracking on a Btu basis probably the price of natural gas and oil. Here, you have the OPEC cartel imposing a tax on the American people on its own oil. I mean, to me this whole thing has been so insane for people to argue that we have to let oil prices rise to their true value. What the hell is their true value? It is what OPEC says it is. The greatest free enterpriser in the world would have to, in a moment of privacy, at least admit that there is no free market in oil when you have 13 people sitting around a table fixing prices. We have put people in the slammer for less; at least we used to. We wouldn't anymore. [Laughter.]

Well, that is a separate set of comments. I don't want to get off on that.

Senator **Durenberger**. It is OK for a Democrat to take that tack in this town. [Laughter.]

Thank you very much, Senator.

Senator **Bumpers**. Thank you, Mr. Chairman.

[The prepared statement of Senator Bumpers follows:]

PREPARED STATEMENT OF SENATOR DALE BUMPERS

Mr. Chairman, and members of the subcommittee: The conflicts arising from America's prolonged energy crisis are threatening to blossom into a full-blown economic civil war among the States. If a new civil war erupts, it will not be fought with bullets and blood but with lawsuits and legislation. Nonetheless, both sides agree, the conflict threatens to leave the United States as divided as it was after the Civil War.

Regional differences over energy policy have been simmering ever since the sharp rise in oil prices following the 1973–74 Arab oil embargo. The States are arguing over where to store radioactive wastes from nuclear power plants and what to do about pollution from coal-fired power plants that can create "acid rain" many miles away.

The Treasury Department estimates that State tax receipts from decontrolled oil prices will jump by $128 billion in the next 10 years. More than $106 billion or 83 percent will accrue to just four States: Alaska, Texas, California, and Louisiana.

All across the country, States are moving to enact new taxes on energy production, profits and sales—and trying to stick consumers in other States with the bill. If the trend continues, the United States will be balkanized by regional economic warfare. The economies of 44 States, and particularly States like mine, will be destroyed. An energy importer, if we are subjected to whatever kind of tax any State that produces coal, oil, or gas may choose to impose on the other States.

Mr. Chairman, I would like to address this element of the problem: Excessive severance of taxes imposed on coal by States which hold the richest coal deposits in the entire Nation.

This country has embarked on an aggressive program to convert our Nation's utilities from oil and natural gas to coal. Certainly we have the raw resources we need to accomplish this goal: The coal reserves in this Nation have a greater energy value than the oil reserves of the entire Middle East.

Montana and Wyoming hold nearly half of America's coal reserves, and nearly 75 percent of the coal deposits in those two States is federally owned. More importantly, they hold 68 percent of our deposits of low-sulfur coal, which is of enhanced value in the national transition to coal because it can be burned in compliance with the laws we have enacted to promote clean air. This situation places these States in a position to exercise considerable control over coal development in this country.

These States have now adopted a coal policy, aimed at keeping much of their coal in the ground and at reaping windfall profits on the coal they produce. Through coal severance taxes at exorbitant rates—30 percent in Montana and 17 percent (of which 6.5 percent is a county ad valorem tax) in Wyoming—these two States are imposing their coal policy on the rest of the Nation at an unacceptable and unreasonable cost. My State of Arkansas produces practically nothing compared to those States, but we have a severance tax of 2 cents a ton. Compare that with Montana's 30 percent, roughly $3 a ton; and Wyoming's 17 percent, approximately $1.70 a ton, based on $10 coal prices.

I fully support the right of every State to control the impact of resource production on its own citizens, economy, and environment, through taxation and other means. The States of Montana and Wyoming have taken praiseworthy steps to protect the local environment by passing model surface mine reclamation laws which ensure that coal companies fully reclaim all coal producing land, and bear all related costs. In addition, it is proper that these States should use severance taxes to offset the social costs of coal development to State and local governments. But in the case of the 30 and 17 percent rates of coal severance tax of Montana and Wyoming, established through major tax increases in the late 1970's after Federal law directed utility coal conversion, it is quite clear that taxation is playing a role beyond that of mere compensation for costs actually incurred.

A June 1980 study by the Congressional Budget Office, which compares State costs and revenues of coal production, estimates that in 1981 the States of Montana and Wyoming will enjoy coal revenue surpluses of $10.6 million and $33.5 million respectively, and that these surpluses will grow to levels of $84.8 million and $328.2 million respectively by 1990.

In fact, both of these States earn so much in severance taxes that they are able to place portions of the revenues in untouchable trust funds to earn interest for the future. It is most difficult to sanction a taxing practice which forces out-of-State consumers, already hard hit by inflation, to pick up a huge tab today to provide for undefinable future needs in Montana and Wyoming. The State of Montana has reduced taxes levied only on local residents at least two times since it increased its coal severance tax to 30 percent in 1975.

Let me reemphasize that I am by no means unsympathetic to the problem of States faced with massive resource development. I am fully aware that such development often brings large population increases, and that Wyoming in particular has experienced this phenomenon. It should be noted in this regard, however, that, according to figures published by the U.S. Bureau of the Census, Wyoming is only one of eight States (Alaska, Arizona, Colorado, Florida, Idaho, Nevada, Wyoming, and Utah) whose population grew between 1970 and 1979 at rates in the range of 25 percent to 45 percent. (According to these figures, Wyoming's 1970–79 increase was 35.3 percent, which in real numbers translates to only 117,000 persons.) Yet these States, all of which have natural resource deposits, have not enacted natural resource taxes similar in magnitude to the 17 percent combination of 10.5 percent State coal excise tax and 6.5 percent county ad valorem tax levied by Wyoming on coal. The fact is, even the substantial population increase experienced by Wyoming during the past decade creates costs amounting to only a fraction of the severance tax revenues. I have noted that Wyoming, like Montana, has a model mine reclamation program, and I applaud their careful stewardship of coal lands. However, it bears reminding that the costs of reclamation are borne by coal companies, not the State, and that these costs actually increase tax revenues because they are part of the total market price of coal on which the tax is computed.

It should also be pointed out that these States also receive from the Federal Government a generous royalty rebate, which is 50 percent of the total 12.5 percent royalty earned by the Federal Treasury on coal produced from Federal lands. In addition, Western coal-producing States benefit from the reclamation fund for water projects, which absorbs another 40 percent of the Federal royalty.

Some quick calculations will point out what this means to Wyoming and Montana.

In 1979, 32,340,000 tons of coal were mined in Montana of which 12,900,000 tons were Federal; 71,825,000 tons were mined in Wyoming of which 30,100,000 tons were Federal.

If we assume coal to sell for $10 per ton, which is approximately correct, then Wyoming with a 17 percent severance tax (of which 6.5 percent is a county tax) would have received $21,930,000 and Montana with a 30 percent tax would have received $97,350,000. When one considers that this is in addition to the 50 percent royalty these States receive, the price seems very handsome.

Assuming a 12½ percent royalty to the United States (the minimum permitted by law) 50 percent of which goes to the State, Montana would receive $7,510,500 and Wyoming would receive $18,812,500.

What these figures plainly demonstrate is that low-sulfur coal of the Western States has tremendous profit-making potential, and that coal-producing States are not just taxing to keep up with their costs. Instead, they are reaching out aggressively to grab some of that profit for themselves.

In so doing, they are unnecessarily inflating the cost of electrical energy. Surely that is not an efficient approach to the development of energy. It is particularly intolerable at a time when this Nation is beset by alarming inflation which leaders of both political parties agree poses grave danger to our economy and our citizens. Moreover, over 90 percent of the consumers whose electricity is produced from Montana and Wyoming coal live in over 20 other States, and as a result enjoy no benefits from the severance taxes which they pay in their electricity bills.

In 1973, 35 utilities in 14 States were burning Montana and Wyoming coal; by 1987, those figures will nearly have doubled to 65 utilities in 27 States. In that year, 92.4 percent of the total demand for electricity produced from Montana and Wyoming coal will originate in these 27 other States.

Although my concern about this situation stems from its effect on the Nation as a whole, my own State of Arkansas offers a good example of the direct relationship of these unnecessarily high coal severance taxes to national energy policies and their injurious impact on American consumers. In 1978, Arkansas utilities, barely at the threshold of a massive coal conversion effort mandated by national laws, burned about 1.5 million tons of low-sulfur Wyoming coal at a severance tax cost of approximately $2.1 million passed directly to their electricity customers. By 1985, 4 new Arkansas coal-fired plants will become operational, each burning more than 2.5 million tons of Wyoming coal each year pursuant to a 20-year contract. All told, by the middle of this decade, Arkansas' coal severance tax tribute to Wyoming will reach approximately $19.8 million. The consumers of my neighbor States of Texas and Louisiana will pay even more. Some utilities in those States, finding the cost of American coal, drastically inflated by severance taxes, unacceptable, are exploring the possibility of obtaining coal supplies from Australia, South Africa, Poland, or the People's Republic of China.

That American utilities are considering buying coal abroad is frankly shocking. Our coal reserves are as vast as the oil deposits which have allowed the OPEC nations to grow rich on American dollars. We can and should use our coal reserves to bring foreign dollars back into this country to reduce our balance of payments deficit, which has reached alarming proportions. That object can hardly be attained if the price of our coal is uncompetitive even for our own citizens.

Severance taxes of excessive magnitude can also slow the pace of coal development in this country by deterring demand for Western coal. That fact is apparent from the excess capacity now found at many Western mines and the dramatic decline in new mine openings and new contract signings in Montana since the imposition of the 30 percent tax in 1975.

The success of Montana and Wyoming in maintaining these exploitative taxes, despite the deplorable consequences is an encouragement to other producing States to enact similar increases. In the last few years, New Mexico did enact a coal severance tax increase, and Colorado and Wyoming attempted, albeit unsuccessfully, to do the same. Such initiatives by producing States are, naturally, a source of increasing resentment among energy-consuming States and a goad for retaliation. We cannot afford this kind of divisiveness if we are to have a meaningful and effective pursuit of energy independence and national economic renaissance. As a practical matter, the only remedy lies with the Federal Government because the out-of-State consumers who pay these taxes cannot vote to set more reasonable rates.

For these reasons, I joined with you in introducing S. 2695 in the 96th Congress and am pleased to be an original cosponsor of S. 178 in this Congress.

This bill will establish a limit of 12.5 percent on the sum of State and local taxes which a State may levy on coal owned by the Federal Government and Indian tribes which is shipped in interstate commerce for utility and industrial use. The bill applies only to federally-owned or Indian-owned coal, which, as the property of all Americans, should not be subject to unfair taxation through the unilateral policy of two States.

The 12.5 percent ceiling, established by this bill is more than adequate to meet the needs of the taxing States, while establishing greater equity for the Nation as a whole. The bill rests on sound precedent in previous congressional limitations on State taxes which threaten interstate commerce.

I am of course aware, Mr. Chairman, that your concern in this hearing extends beyond these inequitable coal severance taxes to the consequences of windfall oil and gas severance tax revenues in other States. I believe, however, that a reasonable limitation on coal severance taxes is an important first step in addressing such revenue-shifting issues. Such deliberate exploitation by two States at national expense is grossly, and uniquely, offensive to basic equity and national unity.

Not only as a practical matter, but now also as a legal matter, the only source of a remedy is this Congress. Just 2 weeks ago, ruling on a constitutional challenge to Montana's 30 percent tax in *Commonwealth Edison Co.* v. *Montana*, the Supreme Court refused to disturb that tax. The dissenters pointed out that the majority opinion would permit Montana to raise its tax without limit—but the majority stated that the problem could only be resolved by Congress. Justice White's concurring opinion, while expressing dismay at the possibly "intolerable" burden of the Montana tax, agreed. Plainly, now, the ball is in our court. We must impose some much-needed curbs before the problem of excessive and exploitive coal taxes becomes unmanageable.

Senator **Durenberger**. We are finally getting to Charles McLure. Dr. Charles McLure is from the National Bureau of Economic Research.

I know we have had some logistical difficulties in getting you here. I want you to know how much we appreciate the effort you put into preparing for this hearing and your willingness to testify.

You may read your full statement or summarize it. Do whatever you wish. Your full statement will be made a part of the record.

TESTIMONY OF CHARLES E. McLURE, JR., VICE-PRESIDENT, NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.

Mr. **McLure**. I do want to apologize for the logistical problems. When you finish with the severance tax, maybe you can take up the Post Office.

Senator **Durenberger**. Oh, the Post Office? You want me to talk about that? I would be glad to do that. [Laughter.]

Mr. **McLure**. Despite the abundance of natural wealth that must have been apparent to settlers coming from Europe, the U.S. Constitution does not deal satisfactorily with what has turned out to be an absolutely crucial issue in the financing of federalism: Which level of government should have primary access to revenues from the taxation of natural resources, or whether State taxes on these resources should be limited. The tensions being created by this gap make one wish that the problem had been resolved satisfactorily before the natural resources were discovered, rather than still plaguing us now, when the geographic distribution of natural resources is known and we are no longer ignorant about who would gain and who would lose from changes in fiscal institutions.

In the brief time allotted me, I want to outline some considerations that might have influenced our forefathers had they seriously considered how taxes on natural resources might have best been allocated between the State governments and the National Government. These are directly relevant to the issue of whether Congress should limit State taxes on these resources, and how they are applicable to such fiscal devices as royalties, corporate income taxes, and property taxes, as well as to severance taxes. I will deal only briefly and admittedly quite inadequately with the question of what we should do now, given the unhappy situation in which we find ourselves. But I do think the considerations that I will mention will be helpful to you.

Let us consider first what might happen under three alternative assignments of revenues from natural resources—assignment to producing States, to consuming States, and to the National Government.

Assignment of revenues to producing States would result in concentration of revenues in only a handful of States—Alaska, Texas, Louisiana, Oklahoma, Montana, Wyoming, and North Dakota to mention the more important ones. Producing States could use these revenues in any of four more or less distinguishable ways. They could subsidize investments or payrolls occurring within their boundaries. This has effectively happened in both the Canadian Province of Alberta, and Alaska. Subsidies of this kind almost certainly lead to excessive allocation of labor and capital toward the producing States and away from other States. The economist's task in making this argument—that resource allocation might be uneconomical—is, I am grateful to say, made easier by the fact that the States which are most likely to attract too much labor and capital through this means are probably generally considered to be among the naturally least inhabitable.

The argument is basically the same if revenues from natural resources are used to finance the overexpansion of public services in the resource-rich States. It might appear difficult to argue against increased provisions of schools, health care, air strips in remote areas, roads, and other transportation links in Alaska—to take but a few examples. But both equity and economic use of resources would argue that geographically limited provision of even public services such as these can easily be overdone. There are, after all, parts of resource-poor States that are quite remote. Many areas in the United States have populations every bit as poor and short of public services as some of those in the resource-rich States.

The third alternative involves in-State investment of revenues from resource taxes. To the extent that public investment within producing States would meet market tests, no misallocation of resources would necessarily result. However, investment of public funds in projects that would not pass market tests should be avoided. Unfortunately, it is likely that much of the revenues would be spent in this way.

The only use of revenues by producing States that is likely to pass a test of economic efficiency would be channeling them back to national capital markets so that their use is determined by market tests. One would assume that a reasonably efficient outcome would result from such a policy. Indeed, just as concentration of income among individuals may produce a higher level of capital formation than would an equal distribution of income, concentration of revenues in the hands of a few States that could not sensibly invest them within their own boundaries might also augment national capital formation. But, I should stress, if State revenues are used to finance activities in the rest of the country that are uneconomical, the outcome would not be particularly desirable.

Consider now the possibility that resource-consuming States might be given priority in the taxation of rents from natural resources. Such an arrangement would mean that the cold and energy-inefficient States of the Northeast would receive a disproportionate amount of tax revenues from this source and that economic activity would therefore be misallocated toward those States. Moreover, though it is not inevitable, events suggest that these revenues might actually be used to subsidize excessive energy consumption in those States. Even worse. unless there were fairly strict Federal guidelines, attempts by consuming States to get their share of the fiscal pie such as we have seen in New York and Connecticut would create the kind of anarchy that is hardly conducive to rational fiscal federalism. Thus, primary taxation by consuming States has no more to recommend it than does primary access to revenues by producing States.

Though I am not a great fan of centralization of government, I am led by the above arguments to the conclusion that an intelligently structured Constitution would provide for the Federal taxation of rents from natural resources. Revenues from this source could be used either to augment capital formation or to substitute for other taxes that have undesirable economic effects because they distort economic choices. There might, of course, be pressures for Federal subsidization of energy consumption. These should be withstood, because they would result in the geographic misallocation of economic resources to consuming States, as well as to the aggregate overconsumption of energy.

Having made this strong judgment, I must briefly consider several potentially important qualifications. The brevity with which they are covered does not indicate a lack of importance. First, exploitation of natural resources often involves relatively localized environmental damage. It is therefore quite legitimate to argue that areas affected by these environmental costs should be compensated, so that the damages can be avoided or repaired. Conceptually this means that economic rents from natural resources to be made available to the public sector should be measured only after all social costs of extraction and processing have been considered. I would like to emphasize the last sentence. It does not, however, say that producing States should have total access to revenues from natural resources.

Any limit on taxation should take environmental effects into account. Of course, estimating these costs will not be easy. It is quite possible that appropriate limits on State taxes on coal and oil should be quite different.

Exploitation of natural resources often begins quite suddenly. Boom towns grow up and investment in infrastructure tends to lag behind, leading to a deterioration in the quality of life in producing areas. Then when deposits are exhausted, resource-related industries die, leaving behind residues of problems, including aging populations and inadequate tax bases. This pattern does not, however, imply that affected areas should have total access to revenues from natural resources, or even worse, that they should have Federal assistance. After all, these regions may ultimately, if only temporarily, be among the wealthiest in the country. Rather, institutional changes are required that would encourage internalization of costs of boom towns and the ensuing reversal of progress. What I am saying is that when considered in the long run perspective, resource-rich areas should be able to finance necessary public services just as other areas should be required to do so. This may require greater and nontraditional access to capital markets; it does not necessarily imply that producing States should have sole access to natural resource revenues. Indeed, if they do have sole access, the boom may be accentuated and the ultimate bust may therefore be more severe.

I want to speak briefly on the distributional aspects of this issue. First, note that the efficiency argument for Federal taxation or for limits on State taxation made earlier does not depend on any assumption that consumers bear the burden of taxes on natural resources. The argument is based on geographic concentration of revenues, not on tax incidence. In fact, I do not believe that in most instances taxes on natural resources are shifted to consumers, except where long-term contracts or price controls provide passthrough of taxes. Thus, I believe that arguments based on shifting to consumers are often both wrong and largely irrelevant. I would, however, emphasize another possibility, that the taxes may be exported to the Federal taxpayer in the form of lower royalties.

The most important qualification that must be made to the analysis presented thus far is to bring it back to reality. We are not, after all, writing the Mayflower Compact. Rather, we know where the bodies are buried—that is, who is likely to gain and lose from various alternative tax policies. That is why the issue is so controversial. However, I think that the efficiency argument made above is sufficiently compelling, especially in light of what we have already seen, that we should not leave the taxation of natural resources entirely to the discretion of the producing States. Those States should receive enough revenues to cover environmental and other costs, plus a reasonable margin of error, but perhaps not much more.

Representatives of producing States will doubtlessly attempt to rebut my position with arguments that make reference to a "birthright." I would answer this by asking why natural resource wealth is any more the birthright of a particular State than of the entire Nation, especially when much of the wealth is on Federal lands and when access to the birthright depends on historical accident of where State boundaries were drawn and tends to be open to anyone willing to migrate to the State. Beyond that, I would note that I recall hardly anyone arguing that the natural wealth of the United States should be returned to the Indians, whose birthright it originally was.

Senator **Durenberger**. Thank you.

That is a good point on which to conclude.

That is one of the points where there was a great deal of difficulty in dealing with it. One of these days the Supreme Court will have to deal with it also, particularly as it relates to mineral resources.

One of the issues which keeps coming up, as Senator Bumpers referred to it, is the fact that it is possible, particularly as we view energy economics today, for a combination of States—not very many of them—to give direction to the national energy policy by forming a cartel and controlling production through their tax systems.

Would you agree with that?

Mr. **McLure**. This borders on the question of whether or not the taxes of the producing States can be exported. There I would have to distinguish the situation with regard to, say, Alaska oil on the one hand and coal on the other hand. I believe, as you said, with respect to iron and taconite, that it is very unlikely that Alaska indeed has very much impact on the world price of oil. Therefore, it is simply getting part of a certain amount of revenue. Perhaps a better case is Texas, where you have more private ownership. I think there it is quite clear in that the price is basically linked to what is set by OPEC—at least insofar as new oil is concerned—and that the tax would simply come out of the income of the owners of the resource.

In the case of coal the situation tends to be quite different because of the long-term contracts. If the long-term contract provides both the passthrough of severance taxes and the sale of a fixed quantity, then there is no doubt about who bears that tax. It has to be the consumer. So far as new contracts are concerned, we are more in a situation like the situation with oil.

Coming back to the question of whether or not the States can make energy policy, to the extent that they do raise the price of the resources above what they otherwise would have been, naturally they have some impact on the particular mix of resources that are being utilized.

Senator **Durenberger**. That is particularly true to the extent that they could control through taxation the price of all resources regardless of whether they are on private land or on Federal land.

Given the difference between coal and oil, as you have mentioned, it is particularly important to coal as long as they have the unlimited ability to tax coal on Federal land.

Mr. **McLure**. I think I would distinguish, though, between the cases of where you do and do not have a long-term contract. If you don't have long-term contracts, then you certainly are not going to have much effect on the price, because the price will be determined by what OPEC does on oil. But, of course, what you will have is an impact on whether or not, with the high tax, it makes sense to develop coal.

Senator **Durenberger**. Following on that particular line and adopting, for the sake of a question, your recommendation which is that we need to do country building rather than province building, we need to approach this on a national basis. Would your advice to us be to take a look at a Federal land leasing policy, to take a look at the whole issue of royalties, payments in lieu of taxes and that whole area—in other words, the cost of extracting coal from Federal lands? I would guess your answer might be "Yes." I have to tie that to the fact that we have another national policy that says burn coal. This keeps getting in the way of any effort or ability we might have to leverage more than we now have out of our leasing policy.

Mr. McLure. I definitely would say that one cannot look only at severance taxes. At the very least, one has to look also at the corporate income taxes and property taxes. We have already seen Alaska's attempt, as it were, to tax oil every time it passes go—I think of monopoly every time I think of Alaska. That seems to be what they are doing here. So, I think you have to consider all of the taxes.

I remember when I was in graduate school, working on the tax-exporting problem, that it didn't do simply to look at severance taxes. One had to look at the property taxes in certain States because at that time important producers of natural resources sometimes used property taxes and sometimes used severance taxes. They have somewhat different economic effects. But for the problem we are examining now, I think the lesson is that one doesn't want to be fooled simply by the name that is put on the tax.

You made reference earlier to getting the Census Bureau to provide less aggregated data because it is very difficult, as a result, to find out composition of the property tax base across the States. You can get it for some States, but not for many. In fact, I noticed the data were available in substantially less detail than they used to be.

Let me come back to the question of whether we should reexamine the leasing policy. Clearly we should. It is very anomolous that we begin with the situation in which much of the resource wealth of this country was held on public Federal lands, which according to the view that I espoused earlier would be the appropriate way for things to be. Then we basically gave a great deal away to the States, which seems to be rather perverse. Granted I said that the States should receive funds for reclamation and should be compensated for environmental damage. But there is no reason to believe that the percentages in that act bear any relationship to such costs.

Senator Durenberger. Part of your response reminds me of one of the defects in the S. 178 approach to this problem. It deals only with a State severance tax which can go only a part of the way on the fiscal disparity issue. There are so many other ways for a State or local government to get around that. If we are really going to deal with this issue, we need to deal with it in the much broader context of State and local government taxation.

I just have to take this occasion to say that this is one of the greatest frustrations of this issue—the difficulty of getting the attention of the National Governors' Association, the cities, the counties, and the other representatives. They have an awful lot to gain by a New Federalism. As long as it is only the issue of should we have the 12½-percent severance tax on a few coal States on Federal lands, it doesn't seem to be a big problem. They let the Western Governors decide what kind of position they are going to take. We are dealing with a much, much larger issue if we are to take the admonition of the Supreme Court seriously and address the national interest which is involved here.

Mr. McLure. It is unfortunate that so little attention is being paid now, because the longer we wait, more people will have more vested interest on both sides and the more the polarity will grow. Again, it would be convenient had the Constitution dealt with this issue.

Senator **Durenberger.** One of the arguments which could be made is that we, in our national approach to these things, really go overboard in trying to treat the States fairly and sometimes, unfortunately, try to treat them all equally. It seems that, except for Alaska, our royalty policies are pretty much the same wherever you go and whatever the situation may be—the payments in lieu of taxes policies, the reclamation policies, the environmental policies, and even a good part of our allocation system for Federal funds. We try to treat everybody alike, whereas each State has its own particular set of problems. When those problems then get reflected in State taxing systems, we come up with the kind of situation where it is easy for you to argue that the only sensible approach is the national approach even though, by your own statement, you wish you didn't have to come to that conclusion.

I don't know if you have any parting advice. You have outlined the problem for us. If you have any parting advice for us as to how to approach this issue in a context that goes beyond a limitation on coal severance taxes, I certainly would appreciate it.

Mr. **McLure.** To some extent, I think I might only reflect what Senator Bumpers said. If one must estimate environmental costs scientifically, it takes a great deal of study and a lot of time. Indeed, Alaska's oil may be gone by then, and we will be working quite a ways down the road.

I really don't have much in the way of scientific advice. If you woke me up in the middle of the night and asked me to name a tax rate percentage between zero and 30, I probably couldn't do it and have much faith in it. It may be over 30.

Senator **Durenberger.** Let me ask you one question about the heritage fund argument. That is one of the arguments which is always made to justify a higher severance tax. The argument is made that they are necessary because some day the resources will be depleted. You seem to argue that the fact that the social and economic infrastructure may outlive the natural resources really has no particular relevance. I wonder if it is possible to assure its full amortization from the tax revenues. Doesn't this mean that those trust funds are really sort of grossly inefficient?

Mr. **McLure.** If you told me that the trust fund was going to be taken and invested outside of the State, and if you could guarantee that dividends would never be paid to the current residents, then I might accept the notion of having the trust fund used at the time the funds run out to try to ease the transition. However, chances are that people going to Alaska, knowing that big trust fund is there, may very well believe that they are going to get in at the time when they change the rules and distribute the funds. I would hate to see a situation where people would be moving to what, by all accounts, is not the most hospitable climate in the country based on this possibility of receiving the dividends in the future. If they do that, not only is there a sharp miscalculation of the labor and capital that goes with it, but also it just accentuates the long-range problem.

I am obviously reminded of what happened in Appalachia. I would hate to see that repeated in the Western part of this country. Somehow I am a little dubious that the heritage fund approach is better than a reclamation approach. Finally, I would say that it strikes me—and you probably appreciate this better than I—that the politicians representing the States which are now resource-rich, at the time those States become resource-poor, are going to be very unlikely to use the trust fund, I should think, to assist the transition of otherwise displaced persons out of the State. We have a few cases where this has happened. However, by and large, people think politicians are not prone to use public funds to help the transition of this, that, and the other out of the State.

Senator DURENBERGER. The conclusion which you come to—particularly when you look at it from the efficiency standpoint—is that who bears the taxes is irrelevant. We should be concentrating exclusively on the issue of concentration of revenues.

Is that a correct statement of your conclusion?

Mr. McLURE. Yes. I think it is very difficult to say one should not be concerned with a tax export. I think that is too extreme. Let me mention two kinds of tax exporting and notice the difference between them.

Suppose we know that all of the coal in a given State is owned by nonresidents. Also suppose that we know that all of the consumers of that coal are nonresidents. We are asking whether the tax would be borne by the consumers or borne by the nonresident owners of the coal. In either event, it is exported. Clearly when people talk about tax exporting, they are talking about exporting to consumers. Hardly anyone ever worries about tax exporting to the owners of the coal, who may after all be sitting in New York City. It is not hard to understand why they worry about one kind instead of the other. But I think it is true that when one talks about tax exporting and dislikes it, one should make it clear why, that they are pushing a particular kind of tax export.

There is another kind that simply may come out of revenues that otherwise have flowed to the U.S. Treasury, and, therefore, results in higher taxes for all of us.

There are at least three kinds of tax exporting and they are quite distinct.

Senator DURENBERGER. Thank you very much for your statement and for your responses to the questions. We appreciate it very much.

[The prepared statement of Mr. McLure follows:]

PREPARED STATEMENT OF CHARLES E. McLURE, JR.[1]

Despite the abundance of natural wealth that must have been apparent to settlers coming from Europe, the United States Constitution does not deal satisfactorily with what has turned out to be an absolutely crucial issue in the financing of federalism: which level of government should have primary access to revenues from the taxation of natural resources and the related issue of whether state taxes on these resources should be limited. The tensions being created by this gap make one wish the problem had been resolved satisfactorily before the natural resources were discovered, rather than still plaguing us now, when the geographic distribution of natural resources is known and we are no longer ignorant about who would gain and who would lose.

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[1] The author is Vice President of the National Bureau of Economic Research. The views expressed here are his own personal opinions and not those of the NBER.

In the brief time allotted to me I want to outline some considerations that might have influenced our forefathers had they seriously considered how taxes on natural resources might have best been allocated between the state governments and the national government. These are directly relevant to the issue of whether Congress should limit state taxes on these resources. I will deal only briefly and admittedly quite inadequately with the question of what we should do now, given the unhappy situation in which we find ourselves. But I do think these considerations will be helpful.

Let us consider first what might happen under these alternative assignments of revenues from natural resources: assignment to producing states, assignment to consuming states, and assignment to the national government. Assignment of revenues to producing states would result in concentration of revenues in only a handful of states: Alaska, Texas, Louisiana, Oklahoma, Montana, Wyoming, and North Dakota. Producing states could use these revenues in any of four more or less distinguishable ways. They could subsidize investment or payrolls occurring within their boundaries. This has effectively happened in both the Canadian province of Alberta and Alaska. Subsidies of this kind are almost certain to lead to excessive allocation of productive resources (labor and capital) toward the producing states. The economist's task in making this argument is, I am grateful to say, made easier by the fact that the states that are most likely to attract too much labor and capital through this means are probably generally considered to be among the naturally least inhabitable.

The argument is basically the same if revenues from natural resources are used to finance the overexpansion of public services in the resource-rich states. It might appear difficult to argue against increased provision of schools, health care, air strips in remote areas, and other transportation links in Alaska to take but a few examples. But both equity and efficiency would argue that geographically limited provision of even public services such as these can easily be overdone. There are, after all, parts of Maine that are quite remote and many areas in other parts of the United States have populations every bit as poor and short of public services as some of those in the wealthier resource-rich states.

A third alternative is sometimes called "province building" in Canada. To the extent that public investment within producing states would meet market tests, no misallocation of resources would result. But investment of public funds in projects that would not pass market tests or yield a reasonable social return is economically inefficient and should be avoided.

The only use of revenues by producing states that is likely to pass a test of economic efficiency would be what I will term generically, "country building." If funds generated in producing states are channelled back to national capital markets so that their use is determined by market tests, one would assume that a reasonably efficient outcome would result. Indeed, just as concentration of income among individuals may produce a higher level of capital formation than would an equal distribution of income, concentration of revenues in the hands of a few states that could not sensibly invest them within their boundaries might also augment capital formation. But, I should stress, if state revenues are used to finance activities in the rest of the country that are economically inefficient, the outcome would not be particularly desirable.

Consider now the possibility that resource consuming states might be given priority in the taxation of rents from natural resources. Such an arrangement would mean that the cold and energy inefficient states of the northeast would receive a disproportionate amount of tax revenues from this source and that economic activity would therefore be misallocated toward those states. Moreover, though it is not inevitable, events suggest that these revenues might actually be used to subsidize excessive energy consumption in those states. Even worse, unless there were fairly strict federal guidelines, attempts by consuming states to get their share of the fiscal pie such as we have seen in New York and Connecticut would create the kind of anarchy that is hardly conducive to rational fiscal federalism. Thus, primary taxation by consuming states has no more to recommend it than does primary access by producing states.

Though I am not a great fan of centralization of government, I am led by the above arguments to the conclusion that an intelligently-structured constitution would provide for the national taxation of rents from natural resources. Revenues from this source could be used either to augment capital formation or to substitute for other taxes that have undesirable economic effects because they distort economic choices of producers and consumers. There might, of course, be pressures for federal subsidization of energy consumption. These tendencies should be withstood, because they would result in the geographic misallocation of economic resources to consuming states, as well as the aggregate overconsumption of energy.

Having made this strong judgment, I must briefly consider several potential qualifications. First, exploitation of natural resources often involves relatively localized environmental damage. It is therefore quite legitimate to argue that areas affected by these environmental costs should be compensated. Conceptually this means that economic rents from natural resources to be made available to the public sector should be measured only after all social costs of extraction have been considered. It does not, however, say that producing states should have total access to revenues from natural resources.

The exploitation of natural resources often begins quite suddenly. When this occurs boom towns grow up and investment in infrastructure tends to lag behind, leading to a deterioration in the quality of life in producing areas. Then when deposits are exhausted, resource-related industries die, leaving behind residues of problems, including aging populations and inadequate tax base. This pattern does not, however, imply that affected areas should have total access to revenues from natural resources, or even worse, that they should have federal assistance. After all, these regions may ultimately, if only temporarily, be among the wealthiest in the country. Rather, institutional changes are required that would encourage internalization of costs of boom towns and perhaps improvements in capital markets. What I am saying is that when considered in the long run perspective resource-rich areas should be able to finance necessary public services, just as other areas should be required to do so. This may require greater and non-traditional access to capital markets; it does not imply that producing states should have sole access to natural resource revenues.

I want to end by commenting briefly on redistributional aspects of this issue. First, note that the efficiency argument for national taxation made above does not depend on an assumption that consumers bear the burden of taxes on natural resources. The argument is based on concentration of revenues, not on tax incidence. In fact, I do not believe that in most instances taxes on natural resources are shifted to consumers, except where long term contracts provide pass through of taxes. (If they are really taxes on rents from natural resources, by definition they could not be shifted to consumers.) Thus I believe that arguments based on shifting to consumers are usually both wrong and largely irrelevant.

The most important qualification that must be made to the analysis presented thus far is to bring it back to reality. We are not, after all, writing the Mayflower Compact. Rather, we now know "where the bodies are buried" that is, who is likely to gain and to lose from various alternative energy policies. That is why the issue is so controversial. But I think that the efficiency argument made above is sufficiently compelling that we should not leave the taxation of natural resources entirely to the discretion of the states.

Representatives of producing states will doubtless attempt to rebut my position with arguments that make reference to a "birthright." I would answer this by asking why natural resource wealth is any more the birthright of a particular state than of the entire nation, particularly when access to the "birthright" tends to be open to anyone willing to migrate to the state. Beyond that, I would note that I recall hardly anyone arguing that the natural wealth of the United States should be returned to the Indians, whose birthright it originally was.

Senator **Durenberger**. Our next witness is Congressman Byron Dorgan from North Dakota.

Welcome, Byron. We appreciate your participating in these hearings.

I haven't seen your statement yet. I will presume its general tenor and wish to comment that we have invited a wide range of Senators, Congressmen and Governors from States which some people refer to as the energy-rich States. Now North Dakota is in that category.

You and John Melcher have, so far, been the only two who have been willing to come. I have talked to some of the others who have indicated they would like to come some time in the future.

I want to express my particular appreciation to you for being here. I know that in addition to being a Congressman—a newly elected Congressman—you have been past tax commissioner of the State of North Dakota. You have a particular perspective to lend to these hearings on fiscal disparity.

TESTIMONY OF HON. BYRON DORGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Representative **Dorgan**. Thank you, Mr. Chairman.

I appreciate the opportunity to appear.

I do have a particular perspective on this issue. It is an issue that I have dealt with in my capacity as tax commissioner for a number of years.

As you know, the subject of coal severance taxes represented the most volatile and most interesting political topic in North Dakota for a 6-year period. We have been through some really interesting battles in the legislative assembly, and in other places in North Dakota, about what kind of severance tax a State should enact on the extraction of coal.

It is my feeling that there has been a track record created around this country that tells us something about coal development. Coal development is unlike a lot of other kinds of development. In our case it requires strip mining.

We have low-sulfur, but also low-Btu coal. You have to strip the overburden away in order to get to the coal seam and take it out. Because our coal is low-sulfur, low-Btu, and is by weight about 45 percent water, we can't strip it very far. So it is burned within the State in mine-mouth electric generating plants.

We have with coal development an industrial activity which requires the mining of coal—the use of that coal either in an electric generating plant or, within the next few years, a coal gasification plant. That kind of activity poses certain special kinds of burdens on a State like North Dakota. A sparsely populated State, in which a substantial amount of industrial activity is taking place in a concentrated area, does incur certain economic and social costs that are not inherent in other parts of the country.

There are a lot of costs that are easy to recognize and ascertain and there are other costs that are hidden costs. I think the track record in this country, in the past, has been one of neglect. We have seen the scars of unplanned coal development all across Appalachia.

One of this country's largest coal producing counties also happens to be one of the poorest counties per capita in America. There is so much overwhelming evidence of a lack of planning, a lack of management by coal producing regions that North Dakotans decided to try to do it the right way. We decided that we were going to attempt to pay for all of the costs while they are being incurred, rather than charge those costs to another generation. We don't want to leave it to the people who come along behind us to clean up, to take care of the spoiled banks, to take care of the air pollution, to deal with the bust phase of the boom/bust cycle. We have really tried to do it a little better than has been done in the past in this country.

I testified before Senator Baucus' committee last year at a hearing he held in Billings. I talked then about what I called the "Texas Hog Rule"—half in jest but, nonetheless, I think it made the point. Texas is a State that produces a substantial amount of oil and gas. Oil and gas taxes put well over $1 billion a year into their treasury. We pay part of that cost when we purchase gas at the pumps in North Dakota. Nobody has complained about the rate of taxation on oil and gas. Texans have had their way for a long time. Then the utility companies and public officials from Texas took a look at Montana and North Dakota and said "Wait a second. We notice you are taxing coal. We want to tell you how to tax coal." The "Texas Hog Rule" I described is where you take what you want along the way; then, when somebody else tries to take a little bit, you start complaining a lot.

I would like to comment about those complaints. No. 1, the complaints are, in my opinion, largely complaints from the utility indusdustries and from the service areas which are provided electric power from those utility industries. They suggest, somehow, that the severance taxes imposed by producing States represent a significant portion of one's electric bill. I am saying that is just not true. The statistics don't bear it out. The North Dakota Legislature, after significant debate, decreased the severance tax in North Dakota from, I believe, around 90 cents to something like 80 cents a ton.

The news media went to the utility companies which had been fighting the severance tax by saying that the severance tax represented a major part of the cost of the kilowatt hour. The news media asked "Now that you have a cut in the severance tax on coal, when will that show up in the electric bill—when will the bill be reduced?" The utilities said the cut in the severance tax wouldn't show up in the electric bill because severance taxes don't represent a significant part of the consumer's electric bill.

I think that is the best test of where the accuracy is. Even under the most extreme of circumstances, a 30-percent severance tax will represent no more than 2½- to 2¾-percent increase in the electric bill for someone living in Minneapolis, Chicago, or Detroit. As compared to the freight rates charged on a ton of coal, that is absolutely minuscule. I am talking about—in Montana's case—a $2.50 per ton severance tax. The freight rate on a ton of coal to be hauled from Montana to Detroit is something like $17 a ton.

Recently a State senator from Montana made the point that the 1-year increase in the freight rate for coal that was announced about 1½ or 2 years ago by the railroad was more than the entire severance tax in the State of Montana.

The point I am making is that the severance tax imposed by the producing State is not of major consequence with respect to the part it plays in the pricing of the kilowatt hour of electricity.

The question is, should the Federal Government decide now to step in and tell the producing States that it would like them to charge only 12½ percent in severance tax on the extraction of coal. That will ignore considerations such as the fact that each State has a different tax mix. One State might charge 12½ percent in the extraction of coal, plus a sales tax, plus a property ad valorem tax on the coal. North Dakota on the other hand only has a severance tax. We have chosen that tax mix. Wyoming has a different approach. Montana has yet another approach. Just taking a look at the severance tax by itself ignores the realities of the tax mix system.

The question is, should the Federal Government, at this point, become concerned and decide it is going to do something about it? I answered that from time to time by quoting Alexander Hamilton, who in writing the Federalist Papers from his description of the Constitution, said that it was the intention of the Constitution to insure that the individual States should possess the authority to supply their own wants and that the States should retain that authority in the most absolute and unqualified sense.

I think what we are talking about here is the hope by some that we could expand the Federal role to begin regulating State tax bases. This comes at a time when most of us are suggesting that the Federal role should be contracted rather than expanded. It seems to me that this is the wrong time to do it, No. 1; and No. 2, I don't think there is good constitutional authority to begin intruding on what I think is a State's right.

I would like to make two other points, without going over the arguments that I am sure you have heard time and time again. I would like people in Congress who complain about the Montana and North Dakota severance taxes to begin trusting the marketplace. The marketplace has been discussed a lot in this Congress.

Every time somebody stands up, I hear them talking about free market, free enterprise. If the marketplace is something that we can trust, then the marketplace will determine when the severance taxes imposed by Montana are extraordinary. The marketplace has not determined that to be true. The fact is that in Montana the coal companies dug in their heels and said "If you pass that 30 percent severance tax, by God, we are pulling out." Montana passed the tax. About 6 or 8 weeks after the legislative session the largest coal company in Montana announced the largest expansion in the history of coal development in Montana. They knew they weren't pulling out. They did that because they know the severance tax is not a major portion of the price of a kilowatt hour.

I understand why some people are concerned about it. I think the concerns are ill-founded. I think the facts do not support the contention that anyone is overcharging on severance taxes. In Minnesota, for example, many cities which are served by Northern States Power, which purchases its coal from Montana and pays the 30-percent severance tax, receive power at a lower rate per kilowatt hour than do North Dakota customers of the Montana-Dakota Utilities Co., which does not use Montana coal.

I think that also describes why the severance tax is not the major problem in pricing the kilowatt hour today. I think I have told you everything I know about the subject, but I have a lot more to say. [Laughter.]

I would be glad to answer any questions that you have. It is sufficient for me to wrap up by saying that I think this kind of legislation is ill-advised. I think it is wrong. I don't think the facts support passing this kind of legislation. I resist it.

Senator **Durenberger.** If you have nothing more to say, I probably shouldn't ask you any questions, except I know——

Representative **Dorgan.** That is appropriate.

Senator **Durenberger.** I know that you will have a great deal more to say on the subject and a great deal more to add to the discussion. I want to start by expanding for you the notion of exactly what it is I think we ought to be up to here. You haven't had the benefit, as I have, of sitting through 2 days of hearings on this subject and then saying that this is just the start. There will be many more.

One of the things we are trying to do is look at the issue of severance taxes and the recent Supreme Court decision in the larger context of the impact of State taxation on interstate commerce—if you want to look at it narrowly, or if you want to look at it broadly—putting it into the context of the future of the federal system.

You are absolutely right, whether you are a Democrat or a Republican. All of a sudden we are all for getting the Government closer to home. I am sure, because you are a North Dakotan, you have always believed in that. The real issue here is, are they going to have the economic capacity to deal with these problems?

If nothing else, that is the reason why we have to have more than 2 days of hearings. We have to hear from more than just you and John Melcher on this issue. I want to just start out by clarifying a couple of things in my mind about North Dakota. One of the good things which I think has happened through the last 2 days is that we have somehow, at least in this small context, raised the level of the State of North Dakota beyond where it traditionally has been.

You made the statement that North Dakota only has the severance tax. I assume that is true in the context that you do have a severance tax on coal in North Dakota. Let me ask you what other related taxes you have.

Measure No. 6 was passed last year. Would you explain that to us? What kind of tax is it? What kind of revenue is it expected to generate?

Representative **Dorgan.** Measure No. 6 was a tax on the extraction of oil. The tax on the extraction of oil that we have imposed in North Dakota comes to about 11½ percent. We had a 5-percent tax and then a 6½-percent tax was imposed by the last electorate through an Initiated Measure. That 11½ percent, incidentally, despite the cries and protests from folks around the country, represents slightly less than what Louisiana has been collecting all of these years on the extraction of oil and gas. I have never complained about what Louisiana is doing. All of a sudden we hear people becoming concerned when North Dakota wants to tax our oil pretty much like Louisiana taxes theirs.

Senator **Durenberger.** That was a tax on oil?

Representative **Dorgan.** Yes.

Senator **Durenberger.** You also have an in lieu of property tax. Does that cover oil and gas?

Representative **Dorgan.** We have two taxes on oil. One was an in lieu tax of 5 percent that has been in place many years. The second is a tax of 6½ percent imposed on top of that amount by the vote of the last electorate.

Senator **Durenberger.** The only tax on coal is the severance?

Representative DORGAN. Exactly. There is no sales tax and no ad valorem tax.

Senator DURENBERGER. Let me get to the heart of my concerns. A lot of people deal, as you have, with the cost of the severance tax as a piece of the cost of turning on a light switch, and so forth.

Let me start by saying that I can't buy your marketplace argument any better than I can buy Ronald Reagan's or Jim Edwards' marketplace argument—perhaps for different reasons, in this case. It wouldn't surprise me that the coal companies we are talking about ended up staying in North Dakota, despite their threats, because where would they do business? They have the ability to passthrough the cost of taxes and the internalized costs of reclamation and processing, environmental controls and everything else to people in 14 States.

The concern is to deal with your statement that the chief complainers are largely utilities and utility service areas.

You were preceded this morning by a couple of mayors who happen to border North Dakota. They see the effect of the difference between our two States more quickly than others. Mayor Ralph Possehl of Breckenridge and I—and a lot of other people—have been trying very hard, before you became a Congressman, to facilitate the location of a $4.5 million sunflower seed processing plant in Breckenridge.

I want to read from a little AP wire story here. I haven't got the date on it. It is sometime in 1980.

> The North Dakota Border Tax Equalization Commission also approved a 5-year property and income tax exemption for a sunflower seed processing plant near Enderlin, N. Dak.

Excuse me, $30 million. We were dealing with a $4.5 million loan.

> The $30 million plant crushes 1,000 tons of sunflower seeds daily. Construction is expected to begin next spring. The plant will go into operation in July 1982. The property tax exemption in North Dakota would total between $400,000 and $425,000. The board rarely grants income tax exemptions but Dorgan—

who I assume is you as tax commissioner—

> said the tax break might influence the company's decision to locate in North Dakota rather than in Breckenridge, Minn.

The mayor of Breckenridge has nothing against you personally, I am sure. [Laughter.]

Undoubtedly, he and I present this as one instance of what it is that concerns Minnesotans. This is eventually going to concern a lot of people all over this country—the concentration of wealth; the fact that State legislatures, over which we have no control, can make decisions which we can in no way influence in the State of Minnesota. Would you comment on that?

Representative DORGAN. Yes, that was Dorgan who said that. I didn't invent tax competition. In fact, I am a relative amateur compared to my neighbors to the East. Unfortunately the State legislature in North Dakota—like most State legislatures—believes that if everybody is competing for the location of new plants, somehow each will gain. In fact, none will gain. I have done some relevant studies that have been published nationally and show that none of us gain from that kind of competition.

I don't know whether it was on that specific project. However, in one of the projects in the Breckenridge area, the developers came to us in Bismarck and said: "The county people over across the border say that they won't levy any property taxes against us for a certain number of years if we will locate there." They also indicated that not only would property taxes be waived, but they would also be given some preferential bond issue treatment so that they could build their plants with low interest rates.

They were presenting to our State Board of Equalization the package that Minnesota had offered. We said that was fine. We had the power to do what the legislature set in place 10 years earlier—which was to offer to a qualified new business an income tax exemption. The reason we were interested in the sunflower seed plant is because North Dakota leads the Nation in the production of sunflowers.

It would be my hope that we could get rid of all of that tax competition. But I would not support Federal legislation to do that because I am basically a States' righter. I believe the States have to maintain their own tax systems.

Senator **Durenberger**. North Dakota has a relatively small severance tax compared to Montana, at least the percentage of value. Montana's 30 percent tax is in the neighborhood of $2.50 on a ton of coal.

I know, from your campaign and from your service here in the Congress, that one of your first concerns is the effect of high energy prices on inflation. You have repeatedly stated that you don't feel that simple budget cuts and tax cuts are going to remedy this problem since these actions alone don't get at the problem of energy pricing. In fact, I am going to quote a sentence here from a speech you made in the House.

> The small businessman who had to close his doors last week because of energy prices and interest rates is not going to be able to say "Thank you" to a Congress that cuts taxes from income he could not make.

I am wondering if you think that the businessman in Minnesota or other consuming States is going to be able to say "Thank you" to the legislature of Montana or North Dakota for cuts in the taxes of these States from which that businessman does not benefit, while he bears the cost of your tax measure.

Representative **Dorgan**. There is a lot of good dialog on the floor of the House. I appreciate your quoting that. [Laughter.]

I believe that deeply. I think the point here is that the severance tax imposed by the State of Montana has almost nothing to do with the price of the ton of coal. I think that the price of 1 ton of coal is going to be influenced by the price of oil because most energy is priced by the base line price for oil and the equivalent Btu tradeoff between the different forms of energy.

Let me pose an interesting question. Let's say, tomorrow Montana decided to cut the coal severance tax 50 percent. What do you think that would do to the consumer in Detroit?

Senator **Durenberger**. If I look only at Minnesota, it would reduce the electric power rate in Minnesota by that amount through the fuel clauses that operate in our State. I can't speak to Michigan.

Representative **Dorgan**. The only example we have had of that, I think, in the coal-producing State is the reduction in the severance tax in North Dakota.

My guess is the utilities would say exactly the same thing there. They will say, "Wait 1 second. The severance tax is not a major cost of the kilowatt hour." If Montana charges $2.50 per ton of coal, that represents 2 percent of the cost of the kilowatt hour. Even if there were to be an adjustment in the electric bill, the adjustment would barely be recognized. That is the only point I am trying to make. If we are really interested in an electric bill for a citizen who lives in Detroit, let's try to figure out why it costs $17 to ship 1 ton of coal from Montana to Detroit.

We are looking at a mouse in the corner when there is a lion at the door. The severance taxes are not the problem.

Senator **Durenberger**. I have one last question which I have raised earlier with witnesses who couldn't answer it in full. You indicated that, because North Dakota's lignite coal is so wet, it is much better to generate electricity in North Dakota than to try to ship it. Do you have any idea of the proportion of electricity that is exported out of North Dakota? Could you add to that how North Dakota taxes electricity which is generated in North Dakota?

Representative **Dorgan**. Yes. The last statistics I saw indicated that about 66 percent of the electric power generated in North Dakota was exported. It is probably higher than that today. The tax that we impose on the generation of electricity is a terrific bargain. It is the best bargain in the North Dakota Tax Code. Rather than tax the electric generating plants on an ad valorem basis, our legislature in their own kind of generosity decided that they would tax them at one-fifth the rate that others in North Dakota are taxed on similar properties. So the property tax that finally attaches itself to the kilowatt hour that leaves for Minnesota is a fire sale rate property tax which nobody else in the State enjoys. The utility industries did a terrific lobbying job and we have a unique rate. It is not attached to export, obviously. You can't do that. It attaches to the production of the kilowatt hour.

Senator **Durenberger**. So it is equal. Do you have any idea what it generated in tax revenues last year?

Representative **Dorgan**. I don't know offhand. It is not a significant amount.

Senator **Durenberger**. Are there any current efforts in the North Dakota Legislature to change that generosity?

Representative **Dorgan**. Whenever I get back there, I try and mention it. [Laughter.] The legislature is not in session at the present time.

If I might mention one further point, Mr. Chairman, which is that if it is true—and I think we can determine it statistically—that the severance tax in Montana, at its highest rate, affects the cost of a kilowatt hour by less than 2 percent to your customer in Minneapolis or Detroit, then we need to consider the impact of the consumer tax imposed by the consumer State. We have heard that argument before. But you have the choice of imposing a 4-percent tax on the cost of a kilowatt hour, or 6 or 8 percent, whatever you choose. Many of the consumer States do that. I am saying that that decision to impose a consumer tax on the kilowatt hour far outweighs the importance of a severance tax levied by the producer State—the State which inherits all of the considerable socioeconomic and other costs of producing coal.

Senator **Durenberger**. Thank you very much. We appreciate your testimony. I hope you will stay involved in the issue. I know you will. Perhaps we will get together again.

Thank you.

[The prepared statement of Congressman Dorgan follows:]

STATEMENT OF U.S. CONGRESSMAN BYRON L. DORGAN
Before the Senate Subcommittee on Intergovernmental Relations on Proposals to Restrict State Production Taxes on Coal

July 16, 1981

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to share with you some of my thoughts on the proposed federal limitations on the state coal severance taxes.

Before being elected to Congress, I served for 11 years as North Dakota's State Tax Commissioner. During this period, coal development in our state expanded from virtually zero into an industry that will soon be stripmining four square miles and approximately 35-40 million tons of coal each year.

I had to face, as an elected public official, the difficult policy questions that come with rapid coal development--questions that would affect the people of my state for generations.

I concluded early on that the cost of present consumption must not be charged to future generations. The American landscape is scarred with the history of poor planning in the energy development area. A failure to make coal development pay its own way has left entire regions devastated from stripmining, polluted by air emissions, and unable to deal with their problems through their own governments because of a lack of financial resources.

I felt that I had an obligation as Tax Commissioner to try to help prevent my state from repeating these mistakes. I, therefore, took part in efforts to reckon the full range of costs which coal development entailed for

North Dakota and to propose changes in our tax laws so that none of these costs would be shunted off to our children and grandchildren.

The people of North Dakota and other western coal-producing states, such as Montana and Wyoming, have shown that they are willing to allow stripmining to help supply energy to the rest of America. But, we are determined that we will not be made a national sacrifice area in order to heat Minneapolis and air condition Detroit. We are determined that we will not allow the development of this energy without requiring this development to pay its own way. We do not have large industrial tax bases to pick up any slack, and we simply are not going to allow the costs to fall on our farmers, workers, small business people, or on future generations.

The western coal-producing states are, I think, determined to be the first generation of resource developers to heed the old adage, "A stitch in time..."

It is not surprising that the energy industry has objected so strongly. This is perhaps the first time that it has been asked to pay its way. What is surprising is that the utilities and others have succeeded in convincing a number of politicians and consumer groups that the state production, or severance, taxes are a burden on consumers and a major factor behind rising electric rates.

That charge just won't wash.

The cost of these severance taxes is hardly significant to the average residential consumer. Even if a utility's entire supply of fuel was subject to the highest state severance tax--that of Montana--the additional cost would be about 17/100 of a cent per kilowatt hour. That's about 2 1/2 percent of the price an average Detroit Edison residential consumer pays for the electricity.

In practice, of course, the actual amount would generally be much less, because most utilities use a mix of coal from different sources. Frequently, coal severance taxes add less than 1% to the price the utility consumer pays.

By contrast, states such as Texas, Minnesota, and Illinois impose sales taxes on electricity at 5 percent while others like Michigan, Wisconsin and Florida impose sales taxes of 4 percent. The burden these states put on their own consumers is nearly twice the maximum burden that the coal-producing states impose. Why don't Minnesota and the other states ease their own tax loads on utility consumers before pointing their fingers at the coal-producing states like North Dakota?

Why are coal production taxes deemed the targets of federal restrictions, when electricity consumption taxes burden the consumer substantially more?

Consider, for example, the case of Bismarck, North Dakota, and Minneapolis, Minnesota. Minneapolis receives its electricity from a Minnesota utility that burns Montana coal and pays Montana's 27.26 percent severance tax. Yet the rates paid by the Minneapolis consumers are substantially lower than the rates paid by the consumers in Bismarck who are served by a North Dakota utility burning North Dakota coal and are paying our severance tax which averages only 15 to 18 percent.

Clearly, factors other than state severance taxes are at work here. Lets face it. The utility companies are trying to make the coal-producing states the scapegoats for the soaring electricity rates about which their customers are justifiably complaining.

In fact, the proponents of restrictive legislation have not shown that utility rates would be a bit lower even if such legislation were enacted--or, for that mattter, even if the producing states imposed no taxes at all. I have a hunch that the railroads and the coal companies know how much the eastern and midwestern utilities will pay for western coal delivered to their plants, given the cost of alternative fuels, and set their prices according. If severance taxes were reduced, it is likely that the coal companies and railroads would simply raise their prices to pick up part, if not all, of what the states were giving up. Consumers might come out no better than before.

Lets talk a little more about railroad rates. On a per ton basis, these dwarf the severance taxes imposed by western states. For example, Montana's severance tax is currently running about $2.45 per ton while the cost of transporting that ton to Detroit is running about $17.25 per ton. During the past year, the increase alone in that charge was nearly equal to the entire Montana severance tax.

I want to repeat that. The coal freight rate increase alone last year put almost as great a burden on utility consumers as did the entire Montana coal severance tax, which is nominally the highest in the nation.

These freight charges, moreover,explain why the western states must impose higher coal severance taxes than those in the east to generate equivalent revenues.

The high transportation costs for western coal mean that the sales price of that coal is substantially lower at the mine than is the price of eastern coal. It costs about $11 more to ship one ton of Montana coal to Detroit than it does to ship the BTU equivalent of that ton from eastern Kentucky. This is a major reason why Montana's coal, though it averages 8,900 BTU, sells for only $9 per ton while 13,000 BTU eastern Kentucky coal sells for over $38 per ton.

The proposed 12 1/2 percent severance tax limit would require Montana to cut its tax to $1.12 per ton. Yet, at the same time, it would allow Kentucky to raise its tax to $3.25 for the equivalent BTU's of eastern Kentucky coal--about two-thirds of a ton.

It is just plain common sense. The price of western coal F.O.B. the mine is discounted because of lower BTU content and massive transportation costs. Hence a Montana, North Dakota or Wyoming has to levy a tax that is a substantial percentage of the selling price of the coal to cover the costs of development. Certainly, the tax has to be greater than the 12 1/2 percent limitation that is being proposed. Such a limit would be totally unfair to the western coal producing states.

Similarly, the states vary enormously in the way they tax the coal industry. The severance tax is just one part of an overall tax burden. In North Dakota, for example, we have no sales tax or ad valorem property tax on coal. In addition, we provide a deduction for federal income taxes from our state corporate income tax. Such peculiarities--present in virtually every state--make our coal tax burdens much less than one might surmise by looking just at the severance tax.

The severance tax tells just part of the story. You have to look at the whole mix of taxes imposed by a particular state and how they work together, to determine whether the burden on the coal industry is heavy or light. To reconcile these peculiarities and put the states on a common basis, in order to enforce a realistic restriction on state tax burdens on coal production, would take a whole new squadron of federal bureaucrats, and I think that is something we all want to avoid.

Even if the coal production taxes of western states did impose a substantial burden on electricity consumers--a burden, say, as great as that which their own states impose through electricity sales taxes--I believe that this policy would be justified. Under our marketplace pricing system, those who benefit from something are supposed to pay the cost. The example of Appalachia should have long ago etched on the public awareness the price stripmining exacts on the state in which it is done. Still, many people who have not lived in a coal-producing state do not appreciate what is involved.

Any industrial enterprise, regardless of its nature, imposes costs on a given area. Whether it is coal mining or tractor manufacturing, it brings with it the need for schools, police and fire protection, roads, sewers, traffic lights, recreation and health care facilities, courts and jails and all the other things--good and bad--that come with more people. In North Dakota, as in most states, these costs, typical of any industrial development, have traditionally been paid for through a tax on property--an ad valorem tax.

Extractive industries bring another kind of cost--namely the loss of a non-renewable resource. Mining is a "one-time harvest." A ton of coal taken from North Dakota leaves my state one ton poorer for as long as anyone dares to foresee. It would be gross negligence and folly for North Dakota or any state to watch its inheritance ride out on freight cars or electric lines without insisting on compensation to provide for the day when the coal mines hit bottom.

For this reason nearly all energy-producing states levy some type of severance tax to recoup a portion of the value of those resources as payment for the one-time harvest of their resource. Generally, this severance tax is in addition to local ad valorem taxes on the value of the energy reserves in place. For example, Texas levies a 4.6 percent severance tax on oil which is in addition to their ad valorem tax. Louisiana levies a much higher severance tax on their oil--12 1/2 percent--but it is in lieu of ad valorem taxes on the oil reserves.

Coal-producing states like North Dakota, Montana and Wyoming deserve similar compensation. In addition, however, they bear a legion of additional costs not incurred by the oil-producing states.

Drive across a coal-producing state and you will see environmental, social and economic costs associated with coal development that rarely attend the quieter development of a resource such as oil (the Alaska pipeline being, of course, a notable exception that aptly demonstrates the point).

The economic and social costs of stripmining and burning coal vary from state to state and that is why the people of the individual producing state are in the best position to assess this cost and establish the appropriate level of tax, including severance tax. I do not think that the federal government is better able than the people of North Dakota to determine the costs of coal development to North Dakota.

"But what if you charge too much?" you ask.

"Can we?" I ask in return. North Dakota coal, Montana coal--any coal--must meet the test of the marketplace. If we price it too high, our customers will go elsewhere. I can't tell you how many times I heard that argument during the debate over the severance tax in my state. Are the proponents of federal restrictions on state severance taxes now suggesting that the free marketplace is a myth, and that we now need what amounts to partial federal price controls on this resource?

I have heard people suggest that the western coal-producing states will use their resource revenues to help lure industry from other parts of the country. If North Dakota, Montana and Wyoming are pirating industry from the northeast and midwest, then I'd like to know where it's hiding. The oil-rich sunbelt states may be luring industry from the northeast and midwest, but not much is coming to the western coal-producing states against which the proposed restrictions are aimed.

Let us not forget that the Japanese and others are showing increasing interest in western coal. It is simply beyond me why the U.S. Congress would want to force the western states to sell coal to the Japanese at bargain basement prices. Is there something wrong in asking them to pay a price which reflects the cost of development--and which, so doing, helps rectify in a small way our balance of payments problem?

The proposal to restrict state severance taxes on coal production is utterly inconsistent with the direction in which this country is moving--towards fewer federal restrictions on state and local governments, not more; towards more responsibilty for state and local governments, not less.

The major budget cuts that Congress will approve this year will require state and local govenments to assume more responsiblity for providing the services that their citizens need. To meet these responsibilities, these units of government will have to lean more heavily than ever before, on their own revenue sources. It simply is not fair to ask all the states to shoulder more fiscal burden, and then to undercut the ability of some of the states to do it.

Over the next decade, North Dakota and other western states are going to have to bear extraordinary costs connected to rapid resource development. As I've said, our states are willing to do their share. They are willing to see their coal developed, despite the cost and damage this development will bring. They ask only that the federal government not force them to repeat the mistakes of the past--in Appalachia, for example. They want to do it right, to bear these costs in a way that is fair both to their own citizens, present and future, and to those in other states and nations who run their air conditioners and clothes dryers and toasters and television sets thanks to this coal development.

Mr. Chairman, I do not question the intentions of many of the supporters of the prepared federal restrictions. What I question is the proposal to which these supporters have lent their names. It will not do what the utility companies say it will do. It will not mean cheaper electricity for consumers and industry. All it will mean is unnecessary hardship for the people of North Dakota and other coal-producing states and a further erosion of our federal system of government.

If this Committee really wants to do something about the price of electricity generated from coal, wouldn't it make sense to look at freight rates and plant construction costs, which together comprisewell over half the cost of electricity, rather than at a state tax which comprises frequently a fraction of 1 percent? A handful of western states may seem like easy targets. But anyone who thinks that attacking them is going to give much relief to utility consumers, is barking up the wrong tree.

Senator **Durenberger**. Our last witness today is Jim Rosapepe, the Washington representative of the Multistate Tax Commission.

Thank you very much for your patience. We will make your full statement a part of the record. You may abbreviate it if you want.

TESTIMONY OF JAMES C. ROSAPEPE, WASHINGTON REPRESENTATIVE, MULTISTATE TAX COMMISSION

Mr. **Rosapepe**. Thank you, Mr. Chairman. I will do that.

Let me start out by saying that I appear today representing the Multistate Tax Commission. It is an organization of 20 State governments across the country, including coal-producing States such as Montana, West Virginia, and North Dakota; and coal-consuming States such as California, Michigan, and Arkansas.

For 14 years, it has been in the business of trying to encourage cooperation among the States in the area of business taxation. So I think the Commission comes to this particular issue with a somewhat different perspective than individual States or individual economic interests.

One of the points, Mr. Chairman, which you made repeatedly this morning, and which I think is terribly important, is that the issue should not be defined as "How high should Montana's severance tax be?" Unfortunately, the issue has, in the past year or so, become defined that way. I think these hearings are really a great step in the right direction in terms of broadening it out.

One of the points a number of witnesses have made which I would like to expand on a little bit is that severance taxation is hardly the only way to skin the cat.

The approach taken by critics of Montana's and Wyoming's coal severance tax seems to be based on the assumption that severance taxation is a particularly bad way to raise revenue. Thus, for example, the proposed legislation doesn't directly address the overall question of the tax burden that a State imposes on coal. The reality is that States currently tax energy production in a wide variety of ways. I think that is an area that the subcommittee may want to develop in more detail. I will mention a couple of aspects of it.

West Virginia, for example, taxes coal primarily from its gross receipts tax and to a lesser extent from property taxation. Alaska uses a special apportionment formula to tax oil producers. Indeed, across the country, States tax property under classified systems in which commercial, industrial, residential, agricultural, mining, and other classes of property are taxed at different rates.

Congressman Dorgan spoke of some of the special conditions in North Dakota. The question then is, if the Congress were to put a lid on severance taxation, States could simply increase their property taxes, change their income tax formulas, or use gross receipts taxes. However tightly you try to draft a severance tax lid, you are going to have great difficulty writing it in such a way that the creative minds in State governments will not be able to overcome it.

Is this a policy that proponents of Federal restrictions intend? Why is property taxation or income taxation all right while severance taxation is not? Obviously, the issue is the overall level of energy taxation by the States.

A second question is whether you really want to take on severance taxation. Anyone who shares the concern about the environmental impact of coal development or who favors market mechanisms, should favor such severance taxation. Mr. Chairman, you made some reference to your skepticism about the role of market in this area, I think everyone would have to agree that the market in the oil industry or in the coal industry is not as perfectly competitive as it is in some industries. However, it is clearly there, to some extent. One of the strong arguments for severance taxation, as opposed to income taxation or property taxation, is that it takes advantage of that. It ties support for government services to the production of the energy resources. In contrast, property and income taxation unravel that, even if they raise the same amount of revenue.

The second issue that I would like to expand on a bit is the issue of consumer State energy taxation. That is on page 6 of my statement. One of the major arguments advanced in defense of the Wyoming, Montana, and North Dakota severance taxes, is that consumer utility taxes in consuming States are often higher then the severance taxes. Therefore if you want to hold down utility rates, lower those taxes. It is a fair point. But it pales in comparison to the interest consuming States are showing in taxing energy companies.

Connecticut imposed an additional gross receipts tax on major oil companies and tried to prohibit, by law, the passing of the tax onto in-State consumers. It hasn't held up in court. However, it takes a little bit of the edge off of the righteousness with which consuming States can claim that producing States are out to rip them off.

New York recently adopted unitary taxation of major oil companies to increase State revenue by $75 million by using the unitary method under their corporate income tax. New York will prevent integrated oil companies from sheltering their profits in paper subsidiaries.

In Wisconsin and other States, legislatures are considering other ways to increase taxes on the energy companies. Will these taxes be paid by in-State residents, exported out of State, or shifted back to the company stockholders? Given the vociferousness with which the oil companies have fought these taxes, one might conclude that it is the industry and not the consumers who carry most of the burden. If that is true, we might also conclude that the mining companies' opposition to severance tax increases, indicates that it is they, and not the consumers, who pay the tax. One of the ironies that I have found is that when you talk with public officials in energy-producing States, they are generally surprised that severance tax increases are seen as detrimental to the consumer. As Congressman Dorgan said when he was tax commissioner in North Dakota, he was always fighting the producing companies. The energy companies in those situations give a very strong impression that they believe that the taxes cannot be passed on to consumers in their entirety.

In any case, the truth is that both consuming and producing States want the energy industries to carry a big and increasing share of the taxload. Federal efforts to stop the producing States can only invite and encourage similar efforts against consuming States.

I might add one other point here. New York's recent move to unitary taxation of the oil companies suggests one of the solutions to the problem about which I know, Mr. Chairman, you are very concerned. I know you are concerned about the electric bills your constituents pay, but I have the impression that you are probably more concerned about the fiscal disparity between States. How are Minnesota, New York, Ohio, and Pennsylvania going to fund their budgets? How are they going to finance State and local governments?

Clearly, what New York has decided to do in this one area is to take the initiative and not just to sit back and complain about what Texas is doing and what Alaska is doing. New York has decided to say there is no reason why they can't, through their own tax authority, through their own legislative activity, pick up an additional share of the pie.

I frankly think that is an area in which we will see more activity. It may be one that your subcommittee may want to address. Federal policy enters in here because, as you may know, there is legislation right now before the Senate Finance Committee that would prohibit the States from using the sorts of taxation methods, the unitary method, which New York has adopted. It seems to me that that sort of legislation poses precisely the same threat to consuming States that, as you are well aware, producing States see in the severance tax.

With that, I would be happy to answer any questions.

Senator **Durenberger.** Thank you very much.

I appreciate your abbreviation of the statement and the fact that the tone of the statement presented was much better than the tone of the statement which was written. I do have a lot of hope that, over the next couple of months, the people who focus on S. 178—which is not the subject of this hearing—can broaden their consideration beyond just that kind of legislation, although that is clearly an important part of the solution. However, the problem now is much larger.

I noticed that you reference the New York tax on oil. I know that Senator Moynihan feels strongly about the State. He also feels strongly about the fact that the producing States should not be able to get cartel-induced economic rents while consuming States don't get a piece of that. I would hope that, in the whole process of looking at taxation, there will be enough people coming at us from enough different directions so that we will find some solution.

I appreciate your bringing up the New York case. I know that you are capable of bringing up a variety of other cases which are coming up with great frequency now in a lot of States; not only on energy-related companies, but on a variety of other companies.

The famous California situation of taxing the foreign source income of major companies, and all of this, reflects the problems that certain States in this country have in meeting the needs of their people. I guess the energy-rich States are taking care of their problems in their way. When my State gets around to extracting copper-nickel, cobalt, and so forth, it will take care of itself in its way.

It is clearly appropriate to look beyond just capping severance taxes. The Supreme Court now has said that the mining of coal is interstate commerce. It has, in effect, invited us to look at who can best make the decision about the mix of taxes which impact, in some way, on the interstate commerce.

You have pointed out very accurately, as others have, that if North Dakota or Montana have only a severance tax on coal, if we were to live with that in some way or take it away from them, they would certainly go back to taxes on income or on property or to some other form of taxes.

If there is going to be an approach to this, it must be an approach that follows the exporting of taxes via interstate commerce. We will have to find either a cap, or some kind of definition of reasonableness, in all of this which will cover all of these taxes and leave the decisions to the States rather than just addressing one of them. Perhaps we can deal with what is a reasonable tax on a particular activity as it relates to interstate commerce and leave it to the States to decide into what mix of taxes they want to go. Is there anything wrong with approaching it in that fashion?

Mr. **Rosapepe.** I think there is. You underestimate the creativity and the inventiveness of our State and local officials. I know you really don't underestimate it, but I think that kind of approach would underestimate it. If you pass a bill like that, 3 years later people will come back in and say, "Did you see what Alaska did?" You can make a career of just dealing with that sort of problem. You would be frustrated in that effort.

The other way you will be frustrated, and I think Dr. McLure's testimony is particularly relevant here, is that it is not at all clear that in most circumstances these taxes get passed on. If they don't, then they don't raise people's utility bills. If they don't get passed on, lids are not going to help you.

It is not going to help Minnesota to put a lid on a tax that Montana cannot pass on to consumers. So I think you are really substantively and economically, as well as politically, barking up the wrong tree to focus on lids. That is not going to put revenue in the pockets of the local governments in Minnesota. What is going to put revenue in the pockets of State and local governments of consuming States is revenue from the Federal Government.

The late Senator Metcalf of Montana proposed, in his tenure in the Senate, a Federal severance tax against which State severance taxes would be credited. That's a very interesting approach, and one that provides some basis for discussion between consuming and producing States.

The other way is for consuming States to enact taxes of their own that raise revenue. But I think you are going to be frustrated if you think it will help the State and local governments to put caps on what producing States can collect.

Senator **Durenberger.** I wish there were more time for us to continue to explore this. I think, through the Multistate Tax Commission, you probably have enough experience personally to provide us with a great deal of advice. I trust that we can continue to count on your counsel.

Mr. **Rosapepe.** Absolutely. We would be happy to work with you as you go forward in this area.

Senator **Durenberger.** Thank you very much.

Mr. **Rosapepe.** Thank you.

[The prepared statement of Mr. Rosapepe follows:]

PREPARED STATEMENT OF JAMES C. ROSAPEPE

Mr. Chairman and Members of the Subcommittee:

I am James C. Rosapepe and I am testifying today as Washington Representative of the Multistate Tax Commission, an organization of twenty state governments. The Commission includes coal producing states such as Montana and West Virginia and coal consuming states such as California, Michigan, and Arkansas.

The MTC, organized in 1967 to promote uniformity in state taxation of multistate corporations, opposes proposals to put federal restrictions on state resource taxes, including coal severance tax rates. As an organization that has worked effectively for almost fifteen years to encourage state cooperation, rather than federal intervention, in business taxation, the Commission believes that such proposals, including S. 178, are unwarranted intrusions into the states' legitimate prerogatives.

The focus of this hearing is on the Supreme Court's recent decision in the Commonwealth Edison Case and possible legislative responses to it. Thus, rather than simply repeat the states' objections to S. 178, arguments with which the Subcommittee is no doubt familiar, I will address some of the broader issues that the Court decision and the proposed legislation raise.

Severance Taxation - Just One of Many Options

The approach taken by critics of Montana's and Wyoming's coal severance taxes, both in Court and in Congress, seems to be based on the assumption that severance taxation is a particularly bad form of revenue raising. Thus, the proposed legislation does not directly address the overall level of tax burden that a state imposes on coal. Indeed, despite some language in the Bill designed to prevent circumvention of its limits through changes in the form of taxation, the states would generally remain free to tax coal production in other ways.

The reality is that states currently tax energy production in a wide variety of ways. West Virginia, for example, taxes coal primarily through its gross receipts tax. Alaska uses a special apportionment formula in its corporate income tax to tax oil producers. And, indeed, across the country, a number of states tax property under a "classified" system in which commercial, industrial, residential, agricultural, mining, and other "classes" of property are taxed at different rates.

North Dakota, for example, has a coal severance tax that could be affected by S. 178 but the state imposes only a minimum property tax on coal fired electric plants. North Dakota could reverse these policies if forced to by federal legislation.

Is this a policy that proponents of federal restrictions intend? Why are property taxation and income taxation alright, while severance taxation is evil?

The one issue the Subcommittee must face is whether, even if Congress wants to, it can effectively restrict the overall, effective level of energy taxation by the states. A limit solely on severance taxes may simply push the states to raise other taxes on energy producers.

Second, does Congress really want to decide that higher property taxes or income tax formulas are preferable to severance taxes? Anyone who shares a concern about the environmental impact of coal development or who favors market mechanisms to allocate economic resources should prefer severance taxation. By tying support for government services to coal production, the severance tax assures that coal development pays its own way. In contrast, property and income taxation unravels this connection even if it raises the same amount of revenue.

It is by no means clear that Congress knows, or even believes, that severance taxes are inferior to other taxes. Yet, that is what federal restrictions in this area would proclaim.

Is Public Capital Formation Bad?

One of the arguments often made by proponents of federal restrictions is that Montana, for example, isn't even spending in the current year all the money it collects from its coal severance tax. The implication of this argument is that the federal government, which can't seem to even balance its budget, should be telling the states that they should not run up surpluses. And beyond that, they certainly should not put aside reserves for the unanticipated consequences of energy development or for economic development when the energy resources run out.

This Congress is devoting much attention to promoting capital formation in the private sector through tax reduction. But when states, such as Alaska and Montana, decide to put aside tax receipts as a form of public capital formation, they are attacked as greedy.

What is the difference between Michigan's "rainy-day fund", set up to save revenue when that state's auto industry was flush, to cover costs when its output of cars and state tax revenue dips, and Montana's decision to put aside some coal severance tax revenues?

In the interest of national economic stabilization as well as balanced regional growth, perhaps the Congress should be encouraging such state practices rather than denouncing them.

Coal, Oil, Gas, and Sunshine

One of the most obvious questions that efforts to restrict state severance taxation raise is "why just coal?" In terms of dollars and of regional development, oil and gas severance taxes in states such as Texas and California should be of more concern to Northeast and Midwest consuming states.

Contrary to the implications of some statements on the "Frostbelt" versus "Sunbelt" issue, Wyoming is not in the "Sunbelt." If Ohioans are worried about their tire industry moving to Alaska, they can relax.

Proponents of federal intervention in this area must address the reality, rather than just the symbolism, of state resource taxation. By most measures, coal production is more environmentally disruptive than oil or gas development. The case for higher, rather than lower severance tax rates on coal is a respectable one. And yet, to date, most of the debate centers on symbolic, but not terribly significant, percentages - 30%, 12½%, 4%.

It will be difficult for the Congress to decide to limit severance taxes on one resource but not on others. Or to put a

12½% cap on coal severance taxes and a lower one on oil and gas. Or to set a BTU equivalency standard.

And what about uranium, biomass, and indeed access to sunshine? The states are not equally endowed with any of these resources. What happens when solar power towers in certain sunny states produce electricity for export and that electricity is taxed?

That is the road that proponents of federal limits may have to travel. And it suggests why Congress may not want to.

Who Pays Severance Taxes?

Who pays severance taxes, producers or consumers? In their appeal to the U.S. Supreme Court, utility opponents of Montana's severance tax argued it both ways. They claimed that it violated the Commerce Clause because it was paid by out-of-state consumers and that it violated the Mineral Leasing Act of 1920 because it reduced future royalties on federal land.

Moreover, supporters of federal intervention maintain that the severance tax significantly reduces use of Montana and Wyoming coal. To the extent that is true - a debatable proposition for sure - it means that, over time, it is indeed producers and royalty owners, not consumers, who pay the tax.

This is not mere quibbling over economic theory. One of the major impetuses for Congressional action in this area is the assertion that producing states in the west are sucking money out of consuming states in the east. If that is not true, if it is primarily coal producers and royalty owners (including the federal government) who pay the severance tax, than the fears of the "Frostbelt"are largely unfounded.

Given the vigor with which many energy producing companies fight increased severance taxes, the argument that producers rather than consumers pay the tax has some plausibility.

Tax Lids Versus Grant Formulas

Another arena of this dispute is federal grant-in-aid formulas. Should formulas, designed to reward in-state tax efforts, exclude severance taxes from the tax base?

If you believe severance taxation is bad, perhaps they should be excluded. But what happens when North Dakota lowers its severance tax and raises its property tax on coal? Change the formulas again?

One might argue that, unlike tax lids, formula changes do not attack basic state prerogatives. They simply are a reflection of the way the federal government wants to distribute tax revenue that it has raised itself. If the federal government wants to reward states with high personal income taxes and low severance taxes, according to this argument, that's fair enough.

Consumer State Energy Taxation

One of the major arguments advanced in defense of Montana's, Wyoming's, and North Dakota's coal severance taxes is that, for many utility consumers in states such as Minnesota and Indiana, consumer sales taxes on utility service are higher than the severance tax. If Indiana wants to reduce utility rates a few cents, why not start with its own sales tax?

A fair point, but one that pales in comparison to the increasing interest consumer states are showing in taxing energy companies.

Connecticut, for example, imposed an additional gross receipts tax on the major oil companies and tried to prohibit the companies from passing it on to Connecticut consumers. (Montana's severance tax is paid by in-state as well as out-of-state consumers.) New York State recently adopted "unitary" taxation of major oil companies to increase state revenue by $75 million. By using the "unitary" method, New York will prevent integrated oil companies from sheltering their profits in paper subsidiaries. In Wisconsin and other states legislatures are considering other ways to increase taxes on the energy companies.

Will these taxes be paid by in-state residents, exported out-of-state, or shifted back to the companies' stockholders? Given the vociferousness with which the oil companies have fought these taxes, one might conclude that they, not their consumers, will carry most of the burden. But if that's true, why not also conclude that mining companies' opposition to severance tax increases indicates that they pay those taxes as well?

The truth is that both consuming and producing states want the energy industry to carry a big, and increasing, share of the tax load. Federal efforts to stop the producing states can only invite and encourage similar efforts against consuming states. That is regional Balkanization.

Isn't the Market Best?

After all the numbers on BTU equivalency, environmental impacts, and transportation costs are noted, for many people the question still remains, "Isn't 30% too much?"

That is not an easy question for Congress to answer either in terms of Montana's needs or its ability to pass the tax burden out-of-state. We all have impressions, opinions, theories.

Everyone admits 12½% is an arbitrary ceiling. How can a less arbitrary lid be found?

Well, as Congress and the President have decided in areas such as gasoline prices and airline fares, why not let the market decide?

It is absurd to argue that Wyoming can raise its severance tax to any level and still sell coal. Not only are there Western states with lower severance taxes, but many of the midwest utilities can buy more coal from Appalachian states. Some utilities are currently buying overseas, and clearly coal faces competition from gas, oil, nuclear, conservation, and renewables.

What is the severance tax rate that will send utility buyers to those competing fuel sources? Nobody knows. It varies from company to company and changes over time. In an era in which industry after industry is being deregulated and the market is to be relied on, it is hard to see the usefulness of ignoring the market in setting an upper limit on state energy taxation.

If the market does not judge a 30% rate too high, that may simply confirm the suspicions of severance tax proponents. That, in most states these taxes are too low.

Substantive Federalism

As Congress cuts federal programs and creates block grants, there is much talk of revitalizing federalism and returning responsibility and authority to the states. President Reagan has advocated returning tax sources to the states, as well. Last year he told the National Conference of State Legislatures: "We can begin to return present responsibilities of government from Washington to the state capitols, but such a devolution of responsibility cannot be accomplished unless ways are found to restore to the state and local governments the tax to finance essential public programs. We cannot balance the federal budget by asking other governments to do the work, while the national government continues to preempt so much of the nation's tax base."

Unless one ignores such statements entirely, it is difficult not to see a certain conflict between revitalizing federalism and restricting state taxation. But it is more than a debater's point.

Over the past several decades, federal intervention in areas as diverse as strip mining regulation and aid to education have been justified by the claim that the states were not doing the job themselves. If you believe in education or environmental protection, or economic development, you were told the federal government had to step in because the states would not act.

Now Congress and the President are changing direction. They are saying, "Let the states do it. Let them set the rules. Let them come up with the money."

And yet, now, when states like Montana, Wyoming, and North Dakota say, "Yes, we'll take responsibility for planning for energy development. We'll make the hard choices between encouraging it and making sure it pays its way. We'll set aside funds for future generations," some interests want to slap these states down.

Substantive federalism that turns back major public service responsibilities to the states requires at least two things:

- increased, not decreased, ability for the states to fashion their own tax structures;
- acknowledgment that state governments are better able than the federal government to evaluate many policy tradeoffs even if the decisions conflict with the preferences of some federal officials.

State energy taxation, as this Subcommittee no doubt understands, is an area both of major revenue significance to many states, and of great complexity and uncertainity. Focusing specifically on severance taxation, one must ask:

- Who is better able to understand a state's current and future revenue needs?

  The state's legislature or the Congress?

- Who is better able to judge the magnitude of environmental and social impacts of energy development?

  The state's legislature or the Congress?

- Who is better able to determine the "right" level of severance taxation that will bring in revenue but not depress production?

  The state's legislature or the Congress?

- Who is better able to decide between severance taxes, property taxes, and income taxes?

  The state's legislature or the Congress?

Almost all the issues in this area - tax options, capital formation, taxation of competing resources, market mechanisms, and tax shifting, are difficult regardless of who decides. If you believe that revitalizing federalism is a significant goal, then keeping those decisions at the state level would seem appropriate.

Thank you for the opportunity to present the MTC's position on this issue and to suggest some areas for Subcommittee consideration. I am happy to answer questions.

Senator **Durenberger**. The hearing is concluded.

[Whereupon, at 12:15 p.m., the subcommittee adjourned, subject to the call of the Chair.]

FISCAL DISPARITIES

MONDAY, AUGUST 31, 1981

U.S. SENATE,
SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
St. Paul, Minn.

The subcommittee met at 1 p.m., at 300 Metro Square Building, St. Paul, Minn., Hon. Dave Durenberger (chairman of the subcommittee) presiding.

Present: Senator Durenberger.

OPENING STATEMENT OF SENATOR DURENBERGER

Senator DURENBERGER. The hearing will come to order.

This hearing is the third in a series on the subject of severance taxes. The Subcommittee on Intergovernmental Relations held 2 days of hearings in July in Washington, D.C. We expect to have one or two more sessions this fall. The record will remain open until the end of October. Anyone wishing to submit a statement for the record is invited to do so.

There is a short phrase in the U.S. Constitution which brings us together this afternoon. It is in article I, section 8. It gives the Congress of the United States exclusive jurisdiction to regulate interstate commerce. It is a powerful clause; its reach is quite broad; and it was intended by the Founding Fathers to be a powerful grant of authority to the Congress.

This phrase found its way into the Constitution because the Articles of Confederation were not strong enough to provide the newly independent colonies with a national economy. Every State was coining its own money, creating its own banks, and taxing commerce to pay for its own militia. The tariffs on imports and exports were particularly troublesome. States used their monopolies over ports and transportation routes to prevent the free flow of goods across the new Nation. The Constitution put an end to this interstate taxation and the economy was unified.

The first severance tax was imposed by the State of Michigan on the mining of iron ore. Minnesota imposed a severance tax on iron ore a century ago. Thirty-three States now have a severance tax in one form or another. These taxes are imposed on a specific commercial activity like mining or oil and gas production. Whether the business is profitable or not, the tax is imposed on the value or the units of production. There are severance taxes on oil, gas, coal, iron ore and taconite, timber, sulfur, sand and gravel, and metals, generally. Recently, a severance tax on corn was proposed by the Governor of Iowa.

For most of the century and a half since 1836, severance taxes have escaped national attention. Congress and the Court have been reluctant to examine the taxing powers of the States. In fact, a 1922 decision by the Supreme Court put most severance taxes beyond the reach of Congress by declaring that mining was not interstate commerce. That decision was overturned in July of this year.

There are many who still share that view, however. They see these hearings and my bill to limit State severance taxes as a small feud between two States over a few tons of coal. They don't want the Federal Government to get involved. However, every American looking at the trends can see the danger, if not the already present damage, that unbridled taxation threatens.

In 1980 the States collected $4.2 billion in severance taxes. This was only a small percentage of their $137 billion in total tax revenues; but it was 50 percent more than was collected in 1979, and nearly twice the figure for 1978. By 1983 the U.S. Treasury Department projects severance tax collections of $9.4 billion—another doubling. Severance taxes may soon become a significant feature in the tax structure of many States.

For some States that day has already arrived. Severance taxes provide 27 percent of all revenues in Wyoming, 22 percent in Louisiana, 21 percent in Montana, 22 percent in New Mexico, 24 percent in Oklahoma, and 23 percent in Texas. If Minnesota had a revenue raiser like that we could be abolishing rather than raising the general sales tax in this State.

Alaska, of course, is the extreme case that is setting an example for the rest of the Nation. In 1980 it raised $1.5 billion in taxes; $50 million in sales taxes, $100 million in individual income taxes, $150 million in property taxes, and all the rest from the oil industry. The severance tax was $500 million and the corporate income tax on oil was $560 million. Now, do you suppose that the people of Alaska paid any of those taxes? You pay the taxes for the government in Alaska. The cost of health, education, highways, and government buildings is exported every time a tanker leaves Valdez. Alaska is exporting the cost of its government to energy consumers all over this country.

As energy prices are decontrolled, some States have the capacity to become virtual tax havens where investments and incomes are shielded from the burdens of State and local government taxation. Across the Nation that burden is somewhere between 10 and 15 percent of the GNP. Imagine the advantage for the few States that can export those taxes.

In this budding warfare without a Federal referee, there is a new trend that is perhaps the most threatening of all. That is, the drive to impose excessive rates—rates outside the bounds of reason—and to deposit the revenues raised in heritage funds to pay for the future, as well as the current, costs of State government. Some States are trying to use our national energy crisis to create an endowment for their future—a perpetual surplus that will allow them to live off interest income. Montana has taken the lead in that regard. One-half of the revenues from its severance tax goes into a heritage fund, and the interest is used for current expenses of government.

We are only in the first skirmishes of the severance tax war. The Supreme Court has decided that it will not be the battleground. In its decision on the 30-percent Montana severance tax the Court cleared the way. The Court extended an invitation, if you will, for the Congress to act. Congressman Jim Oberstar has a bill in the House and I have a bill in the Senate which would limit severance taxes on coal to 12½ percent of the value at the mine.

I am sure we will have to extend that limit to cover all depletable resources. Oil and gas does not flow from the ground forever. Several States are already dependent on billions in revenues from those diminishing resources. As production rates go down, tax rates are sure to go up to protect the windfall. Congress must act now to protect the American public and to preserve that compact between the States, that was written into our Constitution, that secures for all of us the blessings of a free and a national economy.

I am pleased at the number and the quality and expertise of the witnesses who have agreed to testify here today. As I look down my list and look through the audience—unless they have slipped in and have sat down—I do not see the Congressman from the Eighth District to whom I've already referred, or the mayor of Minneapolis. However, we do have State Representative Ken Nelson with us. Ken is the chairman of the energy committee in the Minnesota House of Representatives. He recently joined the national battle on severance taxes at a conference of State legislators from across the Nation.

Ken, we appreciate your being here, and we welcome your testimony.

TESTIMONY OF KEN NELSON, MINNESOTA HOUSE OF REPRESENTATIVES

Mr. Nelson. Thank you very much, Senator. I very much appreciate being here. I was planning to be, as you indicated, a part of a panel. That would have made it simpler, and perhaps I wouldn't have had to speak as authoritatively. Now I must speak authoritatively as the entire panel.

Some of the information I wanted to share is what you have already mentioned. I congratulate you for taking on the issue. As you've well indicated in some previous testimony—I have a copy of your Congressional Record statement here—it is a legislative matter. I was going to quote from Justice Marshall, who, as you know, wrote some of the dissent on the Supreme Court decision saying:

> The appropriate level of taxation that is essential is a matter for legislative and not judicial resolution. The determination is to be made by State legislatures in the first instance, and if necessary by Congress when particular State taxes are thought to be contrary to Federal interests.

I would concur in that this dramatic increase of severance taxes—30 percent, in particular for Montana—is not in the best Federal interest. I'll illustrate that in a couple of ways. I want to underscore that I do think it's a legislative bailiwick, a legislature concern, whether it's State legislatures or Congress.

I'd like to reiterate very briefly some of the statistics that you shared with us in your opening comments because I think it shows a very dramatic and serious trend of the taxing potential for respective States. The formula I have indicates that from fiscal year 1979 through fiscal year 1980, there was a 46-percent increase of severance taxes in this country. A 46-percent increase. That was over $4 billion total amount. A rather dramatic trend.

I also have a table at my office indicating severance tax revenues for fiscal year 1980. It illustrates what the States received, not so much percentagewise, but in terms of total dollars. As you well know, Texas leads the way with $1.5 billion. I see that someone from Texas is to testify later this afternoon. While I realize that Montana is sort of the focus of some of our debate, I think in some ways Montana ought to be thanked for bringing the whole severance tax issue to our attention. Granted they're at the 30-percent tax, but I understand the total is 44 or 45 percent. That is rather dramatic.

According to this table, Montana is getting about $94 million, which pales compared to Texas, gaining $1.5 billion in 1 year from severance taxes. So I hope that Texas is mindful of the fact that, percentagewise, they might be persuasive. As I look at the totals, I think we should ask some questions of Texas, as well as of some other States like Louisiana, Alaska, and such. Sometimes I think Montana is being the whipping boy here. They have brought something to our attention very dramatically.

The final table I'd like to mention is in terms of—and this affects my concerns as a State legislator—the total State tax collections, the severance taxes and how they impact on our total tax collections. For fiscal year 1980, it was 35 percent in Alaska, 27 percent in Wyoming, 24 percent in Oklahoma, 23 percent in New Mexico, 22 percent in Texas, 21 percent in Montana, and 2.6 percent in Minnesota. What these figures illustrate is that the rapid escalation of severance taxes on energy has made a number of these States independent of other kinds of taxing sources. This causes some of us States to have to really double our taxes to keep up, as you alluded to, whether it's property taxes or income taxes or sales taxes. They basically can say that is history for them, and that they're marching on to the future. As you well know, they are even saving for the future with trust funds, which is a very dramatic and dangerous shift for this country.

I would like to make three points, having made those opening comments about our trend. The first point deals with the National Conference of State Legislatures (NCSL). The second point deals with natural gas deregulation. The third point deals with the Federal Government's shift toward federalism, which I think has to be increasingly monitored now that we're sort of over the honeymoon stage of thinking that it's a totally good thing for the States versus the Federal Government.

My first point. As you indicated, I was in Atlanta 3 weeks ago chairing the Energy Committee for NCSL. At that convention we passed a resolution which I was hoping would tell you folks in Congress that we want you to put a limit on those State severance taxes. I was not successful. The Western States were well represented at this conference and they prevailed. I was chairing the committee so I was sort of muffled. We did not really prevail, from my perspective. Montana basically had its way except for a provision that I'd like to share with you. I hope that NCSL brings this to your attention and helps as you work on legislation. I'd like to read about four lines here:

> Because NCSL recognizes that energy-related fiscal disparities among States are a legitimate concern of the Federal Government, NCSL resolves that (1) Congress should monitor the relative impact on States of all Federal fiscal and energy policies.

Congress should monitor the impact of Federal fiscal and energy policies on the States.

> (2) Congress should consider revising formulas for Federal assistance to States as a more appropriate response toward ameliorating energy-related State fiscal disparities dealing with the formula.

I'd like to come back to that a little bit later. That's my first point.

I have 3 minutes now to do my second point. I'd simply like to say that natural gas deregulation can compound the direction we're in, and I hope you will encourage the Reagan administration not to escalate that deregulation schedule. As you know, it's now on a timetable of 1985. The administration, I think, is exploring the possibility of escalating that down to a 1-year time frame, which we in Minnesota generally believe would double our natural gas bills. That would compound this trend that we're undergoing now, from energy-rich to energy-poor States. I would hope that that would be considered as a part of this deregulation concern.

My third and final point is the New Federalism. There I have three concerns because, as you well know, a number of the Federal assistance programs now come back to the States. They provide assistance to the States based, to some degree, on tax capacity and tax effort of which severance taxes are considered a part. That compounds our problem. If the Federal Government is going to continue those assistance programs, it's going to compound the flow of wealth to the energy-rich States away from the energy-poor States. That's a problem.

Another problem is the locational incentives, whether it's for individuals or for businesses. Are energy-rich States going to be able to entice away from those energy-dependent States like Minnesota the business and the people of this country?

Third and finally, I think it's going to set up, as you indicated in your opening remarks, some tax warfare between the States.

So, with those comments, I again thank you for your efforts. Hopefully you can be persuasive with some of your colleagues, including Senator McClure, who might have a different perspective on this from the Energy Committee. I understand that his committee is going to look seriously at this bill. Thank you again for your time.

Senator **Durenberger**. Thank you very much, Ken. You put it into the broader perspective, which I often put it, when you read at least a portion of that resolution which you proposed to the NCSL.

I have been personally frustrated—as I'm sure you were in Atlanta—by the inability to get the Governors or the legislators, particularly from the energy-consuming States, to be of the same mind on this problem like all of the so-called Western or producing States have been. As I heard you put that resolution, it was in the context of "the Federal Government should examine its fiscal and energy policies as they relate to the States." By that I see under "fiscal" a variety of things: From General Revenue Sharing and a lot of other formula programs—which I imagine you looked at or which you would include in that—to the energy grant programs, the energy impact programs and the mineral extraction/production impact programs.

Did you find that you had trouble with a lot of these legislators, even thinking in terms of the impact which the Federal allocation formulas, and things like that, might have in ameliorating this problem? Why couldn't you get this thing passed?

Mr. **Nelson**. Well, that statement was passed, and that was the best we were able to do from the dependent States, if you will. We got language in there which said that we do think that there is a fiscal disparity concern here, and that we want Congress to monitor it as it impacts one way or another on energy and the respective States. So we were successful in that. Basically the resolution said that Congress should not intervene in State taxing policies.

One thing we didn't consider is the fact that you're talking about a limit like 12½ percent on some Federal lands. We did not get into that debate as much as I would have liked. That could have, perhaps, modified some of the resistance coming from the producing States. However, we did get in this resolution, this latter part, over their objections. In fact, I tried to amend it to mention the State energy policies also. That was defeated. The energy-producing States were well represented.

Senator **Durenberger**. Let me ask you then, now that you've clarified my understanding of that, under energy policies—at least for purposes of this question, I will include in that the royalty-sharing policies. Then, let's just stick with coal for sake of definition.

In our legislation we are talking about a limitation on Federal coal on Federal lands. That's 75 percent of Montana and Wyoming. One of the problems here is that while on the one hand the States say "We need the severance tax in order to offset the damage done by the loss and extraction of these minerals," the fact of the matter is when you look at the royalty paid on those coal lands, 90 percent of the royalty stays in those States. Up in Alaska 90 percent stays, right off the top, and 10 percent goes to the Federal Government. In the Lower 48 it first cuts 50–50; 50 percent stays in the State and the other 50 percent allegedly goes to the Federal Government. However, 80 percent of that 50 percent never gets to the Federal Government. It goes back into mine reclamation, and that sort of thing; plus there are built into mining operations internalized costs as well.

So, under even your resolution if we were, as a Congress, to look at royalties on Federal coal on Federal lands and make some changes there, would you anticipate that we might get some problems from Western State legislators if we headed in that direction?

Mr. **Nelson**. We most certainly would. They are really guarding their turf. They're guarding what they have presently and they want to expand. We did not talk at length in our debates about the mine land reclamation issue, whereby the Federal Government already channels back significant moneys; except, Montana did make a point that it was not adequate. So they would argue, I'm sure, that we should not, in any way, diminish their taxing authorities locally.

Keep in mind, as I'm sure you are, that our debate was in the context of State legislators who are very hesitant to give the Federal Government any kind of authority over their taxing power. I can identify with that. I think the issue is how much is fair and how much will be counterproductive for the Nation. I think there's an energy dynamic here of which nobody really understands the full implications. I'm afraid it's going to get ahead of us.

Senator DURENBERGER. I take it there is one area, though, you wouldn't have any trouble telling us to try to put our joint House in order. That is, the way in which we allocate that $80 billion of Federal money going back to the States. Some time ago we started an analysis of all the various allocation formulas. If I had it here, I could drag it out in front of you and show you that there's absolutely no rhyme or reason to any of it—from the medicaid formula with income per capita, income squared, which shows that one of the richest places in the country is the District of Columbia with all of its health problems; to some of them that put most of the Federal money in particular programs; then to a State like Alaska, which we all know has the highest per capita income in the country.

I take it even some of the Western State legislators wouldn't have any trouble if we continued to pursue this side of our analysis, and stayed out of allocation formulas. They would suggest that there is some merit in looking at fiscal capacity. Is that correct?

Mr. NELSON. That's correct. We did get that in our resolution and they're aware of that problem.

Senator DURENBERGER. What happens when we go beyond income taxes, sales taxes and property taxes—which are traditionally looked at, in terms of local effort—to fiscal capacity and start looking at the ability of States to tax minerals? Is that the point at which we might start running into some troubles?

Mr. NELSON. We never really got into that debate. I really can't speak to that.

Senator DURENBERGER. I want to thank you for your testimony. I particularly want to thank you for your leadership here on the State level in trying to address these problems.

The real battlefront for us is out on our Western borders. You're a Minneapolis legislator. It really seems to be very hard to get the attention of the people, way back here in the back lines of the Twin Cities, to the fact that the communities on our Western borders are dying today in front of our eyes. Nobody seems to give a darn. They're dying from the kind of affliction that you're addressing in the legislature. I appreciate it a lot. Thank you very much for being here.

Mr. NELSON. Thank you.

Senator DURENBERGER. Our next witness is the Honorable James Oberstar, U.S. House of Representatives from the Eighth Congressional District of Minnesota. Jim had an opportunity to testify at one of our first hearings in Washington. Prior to that he geared up by addressing a Western legislators' conference out in Colorado, of all places. He is to be complimented for his initiative in this whole area of fiscal disparities on the House side, and for his courage in tackling this issue.

Jim, we welcome your testimony today.

TESTIMONY OF HON. JAMES L. OBERSTAR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Representative OBERSTAR. Thank you very much, Mr. Chairman. I did carry the battle to the National Conference of State Legislatures' meeting in Denver where I debated the Governor of Wyoming.

Let me commend you, Mr. Chairman, for the hearings that you initiated in Washington and these that you are conducting now. Although these hearings are important for the effect we hope they may have on the coal severance tax, I commend you for your awareness of the more fundamental issues involved here: fiscal disparities and their relationship to energy severance tax related matters.

The National Governors' Association has estimated that 78 percent of the total value of budget surpluses enjoyed by States occur in the South and West, mainly in the energy-producing States. Eight States will accumulate more than 90 percent of the increases in State and local revenue resulting from oil and gas decontrol, principally oil decontrol, in this next decade. In addition, taxes levied on all energy production are enabling a relatively small number of State governments to become far wealthier than the overwhelming majority of the States throughout this country. The government of Alaska receives $433 in severance tax revenues for every man, woman and child in that State; Wyoming received $178; Louisiana, $122; and Oklahoma, $93.

The Northeast-Midwest Coalition, of which I am one of the regional cochairs in the House, has estimated that over the next 10 years the projected oil revenues for the State of Texas will total $35 billion; Louisiana, $45 billion; and Alaska, $29 billion. Sixty-four percent of the oil severance taxes from Texas is exported, and 79 percent of the Louisiana tax is exported. As a result of decontrol, severance tax revenues for eight oil producing States will rise a total of $120 billion by the end of this decade.

The effect is to create an enormous disparity in income among those energy-rich States as compared to non-energy-producing States. Those funds will enable those States to finance reductions in taxes from sources that are nonfuel related, to provide business incentives and to improve social services and their infrastructures—roads, water, and sewer systems—at the expense of other States.

Enormous fiscal disparities of this nature will undercut the national interest. That is the issue that runs through the course of the hearings that you have conducted. Those disparities are a step back from our concept of a collectivity in which the Nation as a whole helps certain areas that have lagged behind in development as compared to other areas or the general level of the country.

The ability of States to impose severance taxes is causing an imbalance in the Federal system. Earlier this summer, a task force of the Northeast-Midwest Coalition completed a study of energy expenditures throughout the United States.[1] The study showed alarming differences in the cost of industrial energy among the various areas of the United States. Nationally the average energy price per billion Btus for 1980 was $3,182. In the South and West, the cost of industrial energy was substantially below that of the Northeast and Midwest. For example, in Washington State the price of a billion Btus of industrial energy was $1,452; in the State of Massachusetts it was over $5,100 for a billion Btus. Moreover, the average price for the West is higher because of the factor for one State, South Dakota, which is included as a Western State: South Dakota imports its energy.

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[1] See p. 462.

In Minnesota last year, three Minnesota utilities paid $20 million in coal severance taxes to the State of Montana. Minnesotans paid more of the Montana tax than did people from any other State in the Union.

You and I joined in a lawsuit initially filed by a consumer against the State of Montana. The Supreme Court ruled against us. The Court, however, set the stage for this broader consideration of severance taxes in the ruling that Montana's tax on its coal is constitutional. We can take some encouragement from the fact that the Court said that the level of taxes is a matter for Congress to decide, which supported the argument that we have been making.

We feel that Congress ought to act. You have joined in legislation in the Senate, and I in the House, with identical bills to limit coal severance taxes. We have no quarrel with the right of States to impose taxes for reasonable costs associated with energy development. We know that there are services that have to be provided. We know that there is an impact on the land which must be corrected.

Going back to the foundations of this country and to the establishment of the Constitution, we should note that Madison had seen under the Articles of Confederation that the maritime States had imposed taxes on goods destined for the inland States. He resolved that the Constitution should give Congress the power to impose taxes and take it away from the States so they could not interfere with commerce. We have a similar problem with the energy-rich areas of this country which are imposing taxes on resources exported to energy-poor areas. Congress has the authority, and the opportunity and a very real need to act. Otherwise we will allow the rise of classes of have States and have-not States. We are creating a situation in which States that are feeling the impact of severance taxes on coal, or on other energy, are looking at establishing taxes of their own.

The Midwestern Governors are meeting today in Detroit. One of the subjects they are going to discuss—which is already under substantial discussion among the Governors of Iowa, Illinois, and Indiana—is a severance tax on grain. Washington State is considering a tax on exported lumber which is in great demand, not only here but outside of the United States. New York State is considering a tax on refined petroleum products exported from that State.

If we allow this kind of hodgepodge system of taxes on other items to develop, we will have undone the wisdom of the Constitution, the wisdom of the commerce clause. Congress should act, and not just on the coal severance tax, but on a national severance tax covering all forms of energy.

I thank you for the opportunity to be here with you today, Mr. Chairman.

Senator DURENBERGER. Thank you for your testimony today.

Let me ask you first about practicalities. The previous witness mentioned Jim McClure, the chairman of the Senate Energy Committee. The 12½-percent severance tax bill is not in my committee;

it's in his—a committee that is deliberately dominated by Western States, not for this reason but for a variety of other reasons. I think, in fairness to Senator McClure, his concern is not so much parochial as it is the Civil War problems, and some of the things that Ken Nelson experienced when he went to Atlanta to the NCSL convention.

What is your estimate of the practicalities of passing your 12½-percent coal severance tax limitation bill in the House? Do you have any inside idea?

Representative **Oberstar**. There was a very strong prospect of passing it last year. It was reported out of committee. It was ready for House floor action. There is no question that the votes were there. The same likely would prevail today, although the margin might be closer. Principally because, through the Northeast-Midwest Coalition, we have brought a new level of awareness.

The chairman of the subcommittee is in a better position than I to understand and explain what would happen in the Senate with the prospect of a filibuster. Again I raise the question of how long can a filibuster succeed in the Senate if awareness of the consensus builds up, particularly if the House should act first.

Senator **Durenberger**. There is another side to this issue—two other sides that I'd like to examine with you. No. 1, and we'll probably ask this question of Mark White, the attorney general of Texas when he testifies—there are those who say that one of the objections to a percentage limitation on coal severance tax on Federal lands is that it then becomes an automatic ceiling, or floor, for everybody—whether it's Texas, or whoever, that's down at 4, 5, or 6 percent. They will automatically run up to 12½ percent. I'd be curious to know your answer to that objection.

Representative **Oberstar**. Yes; there is the possibility that other States would raise their severance tax to that level. There are, however, restraining influences. State legislators don't want to be in a position of raising taxes, some of which will have to be paid by the people that they represent. The hearings last year and the report of the bill out of committee was to dissuade Montana and Wyoming from imposing increases in their severance taxes which they had considered. They said, "Congress might act if we pass this legislation now." In the period the bill has been pending in the Congress, no State has increased its severance tax up to that amount just to be there when the bell sounds.

Another approach might be, except for Montana and Wyoming which unconscionably raised their severance taxes, to pass legislation that would freeze the severance taxes in the States at whatever level it is, because most of them are below 12½ percent. That figure was picked rather arbitrarily because it was the highest amount of severance tax, except for Montana and Wyoming, in effect at that time.

Senator **Durenberger**. I think the House tried that on the windfall profits tax—as I recall. Not I, but others in the Senate managed to kick that one out when we were talking about the windfall profits tax and its implications.

The other side of this is, of course, the one that Ken Nelson suggested earlier. That is, I'd be curious to know what your estimation of the situation is on the House side with respect to examining current

Federal allocation and assistance formulas. That is not necessarily just an alternative to a severance tax limitation, but it seems to be something very important that we need to address. Is there anything going on in the House side, or would you think that maybe there would be at least a receptivity over there, for counting fiscal capacity in terms of the ability of the States to use energy and other mineral taxes in allocating that $80 billion in Federal aid which we provide to the States?

Representative **Oberstar.** We have begun a review of that very question in the Northeast-Midwest Coalition to determine whether there is a possibility of making such adjustments in formulas of federally-funded programs. That is one that does require considerable thought and attention. I'm pleased you raised it.

Senator **Durenberger.** Just one last question. We heard earlier that 2 percent of Minnesota's revenue is raised from severance taxes. Most, if not all, of it is raised in your congressional district. If there is to be any potential of future severance taxes on minerals in this State, it's all going to be in your district on copper-nickel, cobalt, or whatever. Would you just reflect for us—at least in the present time, you talked about grain and so forth—what basically is the political mood of your constituency as it relates to a severance tax on minerals in your district?

Representative **Oberstar.** There is an interesting distinction between iron ore minerals and energy, whether coal or oil or gas. Iron ore, converted into steel or other forms, is dispersed so generally throughout the economy that its impact is not felt by any one group or class of users. There is no have or have-not States in that respect. Electricity, oil to heat homes, and gasoline for cars come from a very limited number of States. We have no oil, coal, or gas in Minnesota. Any addition to the price of energy is felt directly and immediately by the consumer. People have made a very clear distinction between energy severance tax and that on iron ore for the reasons I've already cited.

Senator **Durenberger.** So the people in your district would not insist on the Minnesota Legislature passing a 20- or 30-percent severance tax on copper-nickel as the price of extracting it, knowing that these other States are going to need your copper-nickel?

Representative **Oberstar.** The question of severance taxes on hard rock minerals is one that has been cautiously managed by all mineral-producing States, to relate taxes directly to the impacts of production and the depletion of that resource within the State. What is particularly objectionable about the Wyoming and Montana taxes is that those States crying "wolf" about environmental, social and economic impacts have vastly increased their tax and then applied it to other uses. Fifty percent of the Montana tax goes to purposes other than energy impact, and of that amount which is destined for energy impact, half of it is put into a trust fund for some future year. Only 12½ percent actually goes to alleviate impacts in that State.

Senator **Durenberger.** The other part of the problem, of course, is that when you're talking about hard rock minerals, there is a marketplace. You know darn well there is a marketplace for taconite and iron ore. The reason we don't tax it at 4½ percent is because you can buy it cheaper someplace else. The same is certainly now true of cobalt.

It's certainly now true of copper and nickel. That's why it's not being extracted.

There is no marketplace for energy minerals in this world. It's a marketplace being set basically by one country. It is totally unpredictable. We have generally panicked in this country in trying to extract as much of everything as we can. There are some people who are able to benefit from this lack of a marketplace.

So concerning the severance tax being imposed in some of these States—Montana is the best example—there is, at least in percentage if not in amount, a rationality to the Texas severance taxes as a percentage of value. There's hardly a rationality in a 30-percent tax in Montana. It would never survive in a truly competitive marketplace where coal was competing against gas, oil, conservation, alternative energies, and a variety of things.

Representative **Oberstar.** Exactly. We produce more in Minnesota than all the rest of the United States combined, but iron ore is the third most abundant mineral on the surface of the Earth. It's available in greater quantities from sources outside the United States. We have to be very substantive about our competitive condition. The same is true about copper and nickel. So you're quite right.

Senator **Durenberger.** Thank you very much for your testimony. If you want to stick around, you're welcome to do so.

Representative **Oberstar.** I will be happy to remain here for a time to listen to the remaining testimony. I do have other commitments.

Senator **Durenberger.** I understand that. Thank you very much.

[The prepared statement of Representative Oberstar follows:]

PREPARED STATEMENT OF HON. JAMES L. OBERSTAR, MEMBER OF CONGRESS

Mr. Chairman, I appreciate this opportunity to testify before the Subcommittee on Intergovernmental Relations on an issue of critical importance not only to the people we represent in Minnesota, but to the entire Nation.

The concept of "fiscal disparity" on the surface would appear to be a rather dry area of study and of little interest to most Americans. The reality, however, could not be more different.

The National Governors' Association estimates that 78 percent of the total dollar value of budget surpluses occurs in the states of the south and the west. In 1978, more than 60 percent of the total amount of surplus was concentrated in the eight states which will accrue more than 90 percent of the state and local revenue increases resulting from oil decontrol in this decade.

In addition to royalties received for energy production on state lands, taxes levied on all energy production are enabling a small number of states to become far wealthier than the overwhelming majority of nonenergy producing states.

In 1979, the government of Alaska received $433 in severance tax revenues for every man, woman, and child in that state; Wyoming, $178; Louisiana, $122; and, Oklahoma, $93.

The Northeast Midwest Congressional Coalition, of which I am Co-chair, estimates that over the next ten years Texas' projected oil severance tax revenues will total $35 billion, Louisiana's $45 billion and Alaska's $29 billion. In 1979, the last year for which figures are available, 64 percent of Texas' oil tax was exported beyond Texas' border, as was 79 percent of Louisiana's tax and 85 percent of the Alaska tax.

As a result of decontrol of oil begun by President Carter and accelerated by President Reagan, severance tax revenues for eight states will increase by over $120 billion in this decade.

The practical effect of this disparity is that these energy-rich states can use the tax revenues collected, largely out of state, to finance reductions in nonfuel related taxes, provide incentives for business and industry to locate and expand in those states, to improve social services without raising existing taxes, and improve infrastructure in such important areas as water supply and transportation systems.

Enormous fiscal disparities, the differences among the states in the amount of revenues available to them for public services and facilities, undercuts the national interest and runs contrary to historic federal policy.

Throughout our history, the federal government has acted to help those areas of the country lagging behind in development.

It has meant that the citizens of the entire United States have provided billions of dollars for water projects in the west and for a highway system to link the entire country. The disparity encourages a migration of jobs and capital from energy-importing states in the northeast and the midwest to the royalty-rich states of the south and the west and undercuts further the ability of our states to maintain our industrial base.

In July, the Northeast-Midwest Congressional Coalition released the results of a comprehensive study of the energy expenditures of the United States. The study provided alarming figures about differences in the cost of industrial energy among the four regions of our country. In 1980, average energy price per billion Btus in the United States was $3,182. Both the south and the west enjoyed industrial energy prices below the average. The northeast and the midwest both had higher. The northeast at $4,256 and the midwest at $3,231.

Among individual states the difference in industrial energy prices is astounding. For example, the average price of 1 billion Btus of industrial energy in Washington state is $1,452; in Massachusetts that cost is $5,150.

The impact of energy severance taxes is reflected in the amount of severance tax paid by the people of Minnesota to the state of Montana for the coal used by Minnesota consumers. In 1980, three Minnesota utilities paid a total of approximately $20 million in coal severance taxes to the state of Montana, over a quarter of the total revenue received by the Montana Department of Revenue from the 30 percent coal severance tax levied by the state.

Mr. Chairman, you and I joined as amici curiae in a suit before the Supreme Court challenging the constitutionality of the Montana tax. Unfortunately, the Supreme Court found the tax was not unconstitutional. The Court, however, did provide Congress a clear statement of its authority to determine reasonable standards for energy severance taxes.

In the majority opinion the court stated "The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution."

Justice White in his concurring opinion stated the case for Congressional action even more clearly:

"Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. . . . The constitutional authority and machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress, and surely Montana and other similarly situated states do not have the political power to impose their will on the rest of the country."

The Court has pointed the way for Congressional action, and we should establish reasonable limits on severance taxes.

I am a sponsor of HR 1313, the House version of the legislation introduced in the Senate by the Chairman of this Subcommittee. It is a good bill, one which I hope we can enact. While enactment is important to Minnesota, our concern appropriately goes beyond limiting the severance tax charged by Montana. While the rate of Montana's tax is high, the severance taxes charged by oil and gas producing states cost consumers in energy-importing states far more and are the source of an even greater threat to our federal system.

The issue is not the right of a state to impose a reasonable tax to provide essential services, mitigate any damages resulting from the extraction of the energy product and to compensate future generations for the depletion of a nonrenewable energy source. The issue is the extent to which the federal government, and specifically the U.S. Congress, can permit a small number of energy-rich states to charge exorbitant taxes, reap billions of dollars of revenues and effectively shift the cost of their government services from their own residents to those of the other states.

The people of Minnesota are in effect paying for government services provided in Alaska and Texas. Contrary to the principles of our democratic, federal system, the decision on the level of taxation paid by most Americans is being made not by their own representatives, but by the legislatures of a small number of states.

The ability of these states to assess our constituents these excessive and unreasonable taxes undercuts the notion that we are, first, one Nation, and, second, a union of states. This capability threatens the balance of shared power between the federal government and the state governments.

The excessive coal severance taxes charged by Montana and Wyoming, however, are symbols, but not the real problem facing the people of Minnesota, or the entire nation. It is a national problem, because of the effect that the fiscal disparities have on our federal system. The process of enacting responsible, reasonable changes in the current severance tax system will be long and involved. I seriously doubt that we will enact legislation limiting severance taxes in this Congress.

The Chairman of this Subcommittee is in the best position to describe the ability of energy-producing Senators to delay consideration of severance tax legislation. Furthermore, I suspect that the Reagan Administration is not yet of the opinion that the federal government should act to restrict the right of energy rich states to levy severance tax.

Those of us who are deeply concerned about the issue of fiscal disparity must undertake a massive educative process. The impetus for action will increase as severance tax revenues increase far beyond historical levels. As states receive the projected revenue levels, the problem of fiscal disparity will intensify, as will the urgency of a federal solution. The major avenues of approach include:

Changes in federal aid programs to the states to reflect accurately the differences in state revenues as a result of severance taxes;

Enactment of legislation limiting state severance taxes, either as a percentage or as a dollar amount, on the basis of such factors as economic and social dislocations of the extractive process, state population and the needs for conservation investments;

Changes in such laws as the Mineral Leasing Act of 1920, which gives the states 50 percent of the royalties from mineral extraction on federal land; and

Enactment of legislation to provide a mix of federal and state severance taxes to distribute more fairly severance tax revenues and to insure the stability of all state governments.

The hearings of this Subcommittee are an important step in the process of developing policies to preserve our federal system, and to prevent dangerous levels of fiscal disparities among our states.

If Congress fails to act, we face a dangerous situation in which the majority of states will be forced to enter into tax warfare among the states, in order to recover the lost revenue flowing from their states to the energy-rich states. The United States must not become an association of 50 states, each of which is trying to export the burden of taxation, in order to force citizens of other states to pay for the their states' services.

Thank you for this opportunity to testify.

Senator DURENBERGER. Our next witness is Hon. Donald Fraser, mayor of Minneapolis. In addition to being mayor of Minneapolis and former Congressman, Don is chairman of the National Coal Consumers Alliance—a coalition of public officials who have banded together to raise the issue of excessive severance taxes on coal.

Don, we appreciate your being here and look forward to your testimony.

TESTIMONY OF DONALD M. FRASER, MAYOR, MINNEAPOLIS, MINN.

Mr. FRASER. Thank you very much, Senator. I have a written statement which is short enough so that I think I'll stay within the 10-minute rule or 5-minute rule.

I welcome this opportunity to testify on the impact of coal severance taxes on cities in our part of the country. I'm testifying today both as mayor of Minneapolis and as chairman of the National Coal Consumers Alliance Steering Committee.

Minneapolis, which is the largest city in Minnesota, gets nearly all of its coal from Montana. Montana is currently levying a severance tax of 30 percent based on coal mined within the State of Montana. This tax is largely exported to the consumers of coal, which include the utilities and ultimately the users of electricity.

Northern States Power is the utility company supplying our city with electricity. They paid $11.8 million in severance taxes in 1980. This amount was passed along to the customers. If one breaks out the proportion of customers within the city of Minneapolis, the total bill came to $1.246 million. That comes out, for a typical residential consumer who would use 500 kilowatt hours of electricity, to about $2.75. That's what we pay in tribute to the State of Montana. While this amount may not appear large, it does represent an add-on to the inflationary increases which are hitting the people who live here, as well as the city government itself.

Our city is experiencing very large increases in the costs of utility-type services. For example, in our 1982 budget we had to plan for energy increases of 11 to 20 percent: solid waste disposal going up 27 percent, natural gas costs increasing by 20 percent, and sewage treatment costs increasing 36 percent. So we're faced with an upward trend in the cost of all of these items. Anything that adds further to it is simply adding to the burden on the city.

But there's more than just the actual monetary injury. Energy-rich States are fortunate to have these resources which do bring them large amounts of money. I think Congressman Oberstar outlined that quite well. I think the States are entitled to tax the profits from these enterprises. It doesn't seem reasonable to me that the States should be able to impose severance taxes which are not related to the legitimate costs associated with the enterprise but are more related, apparently, to the painless opportunity to tax the ultimate consumers of these energy resources who derive no benefit from the associated governmental expenditures within the producing State. To put it more directly, the Minnesota consumer of electricity is being asked to subsidize the taxpayers of Montana for Montana's public expenditures.

There is further injury being added to this insult. The General Revenue Sharing formula gives credit to a State for its local tax effort, which is reasonable. This includes taxes collected from the consumers of energy who live a long distance from the State. Thus, the energy-producing State gets a double benefit—the tax liabilities which are exported to others to pay, and then more General Revenue Sharing as a reward for those higher severance taxes.

We in Minnesota are feeling the pinch of reduced General Revenue Sharing. That, combined with other cuts in Federal and State funding, is imposing new and higher burdens on the local government. We're being forced to either cut spending drastically or turn to the property tax, which is the only local tax we control.

This situation is typical for other cities in the Northeast and Midwest. For this reason, I and other public officials have banded together to form the National Coal Consumers Alliance. A Steering Committee, which I chair, includes elected officials from such States as Michigan, Texas, Iowa, and Illinois. The Steering Committee and its legislative allies have endorsed and have actively supported your bill, S. 178, and its House counterpart, H.R. 1313, and the predecessor bills in the 96th Congress. All of these require that the 30-percent severance tax in

Montana and the 17½ percent in Wyoming be reduced to what we regard as a reasonable level of 12½ percent.

The need for remedial legislation is clear. Our country's energy policy mandates that the electric utilities convert to coal. Montana and Wyoming hold 75 percent of the Nation's low-sulfur reserves and 40 percent of all the coal. The Wyoming and Montana severance tax rates were raised only after the focus of our national energy problem was directed to low-sulfur coal. To permit two States to profit from our national energy shortage and to add to inflation is unconscionable, especially since three-fourths of Montana and Wyoming coal is on Federal land, lands which are owned by all of us here in the United States.

In an era when States are short of revenue, the example of Montana and Wyoming may well lead to imitations. Other energy-producing States, impressed by the successes of Montana and Wyoming, are now considering similar tax increases. The result may be an effort to retaliate by energy-consuming States who would seek to impose taxes on the commodities they export. I don't think that effort would succeed but certainly the effort may be made. If it did succeed, it would be chaotic, inflationary, and intolerable. Remedial legislation must be passed before that situation becomes unmanageable.

I appreciate, Senator, the chance to present these views, and I hope that you will be successful in getting appropriate national legislation adopted.

Senator **Durenberger**. Thank you very much, Don. I think it's sort of interesting that the mayor of our largest city and our Governor both happen to be former congressmen with a great deal of expertise, at a time when we have a former Governor as President talking about changing federalism and devolving a great deal of responsibility to the States, with some vague references to also devolving the financial resources necessary to meet those responsibilities.

Let me ask you to share with us your own observations about the future of federalism as you see it—both from your experience in the Congress with a variety of allocation formulas, categorical grant programs, and so forth; and now as the mayor of a major city in a State like Minnesota—in terms of the success of a redefinition of federalism without some attention to these problems of fiscal disparity.

Mr. **Fraser**. Well, in general, I'm in sympathy with the idea of Federal programs being decategorized and converted into block grant funding. We had an era of that during President Nixon's tenure, and I thought it was a good idea then. I think it is again a good idea now. However, I see this as a kind of an evolutionary process. The Federal Government gets into categorical programs often because it thinks there is a need that is not being addressed. I think that's all right. I have no difficulty with that if it's a real need and it's being properly addressed.

After a program has been in effect, for 6 years, however, it seems to me that the State and local governments are up and running. They understand the problem. They're organized to deal with it. At that point I think removing the categorical restrictions is justified and, in fact, results in more flexibility at the local level. So, in principle I have no difficulty with that.

What I have difficulty with is the fact that we're having responsibilities devolved upon us without the resources. We're getting the opportunities to address problems, but we're not getting the money which we need to do the job. That's particularly a problem at the local level. If the Federal Government got entirely out of the Federal income tax, that wouldn't help the city of Minneapolis because we can't impose an income tax. Tax reductions at the Federal level don't help us. Local governments sorely lack the fiscal flexibility.

In our city, even if we had the legal authority to do it, it would not be appropriate to impose our own sales or income taxes because we're too small a jurisdiction. We would set up competitive tensions with the neighboring communities and suburbs.

This is one reason that I'm delighted you're holding these hearings in the Metropolitan Council chambers. I think the metropolitan level is the level we could well look to for more flexibility. I hope our legislature will soon address that question, but for the moment we're experiencing significant difficulty.

Our CETA funds are being cut from about $11 million down to about $5 million. This means we are training fewer and fewer people, and we are not reaching the hard to employ, the chronically unemployed, as effectively as we should. I don't know exactly what President Reagan thinks we should do about it. We're making a local effort. We're getting the private sector involved and we're going to see if we can do more for ourselves. But I think the training moneys are going to be important if we're going to be able to do the job successfully. That's only one example.

Senator Durenberger. Let me conclude by asking a few questions I've always asked with regard to the 12½ percent severance limitation. Why 12½ percent? How did you happen to choose that?

When I look at my Northern States Power bill for my home in Minneapolis, I find—I never get these straight: 3 percent for the State and 5 percent for the city, or, turned around—an 8-percent tax on that bill. The Governor of Montana tells me, in total, this is larger on the part of my utility bill than his severance tax. How would you respond to each of those questions?

Mr. Fraser. Well, on the latter issues, these are taxes that are imposed by legislative authority here in the State. The money is paid by State users, people who reside here, and it goes to meet the needs in the State. It's a closed circuit. We don't invite or require people from outside the State to contribute to our tax expenditures, nor presumably do they derive any benefit from it. We deal with our own problems internally in the State.

I think that is not a relevant argument. I know they have raised it, but I don't see that it has any application to the issue at hand.

The 12½-percent figure just seemed to be a reasonable figure. No other State dealing with any other severance tax had a rate higher than that. In fact, I think almost all the severance tax rates are below the 12½ percent. Earlier, when I looked at it closer, it seemed that the 12½ percent came out as a reasonable figure. It is also related to a provision in the leasing of Federal lands. I think there's a comparable figure of 12½ percent. I myself am not wedded to that one figure.

I think the point that we were trying to make is that it's appropriate for Wyoming and Montana to levy severance taxes to deal with costs which are associated with the production of coal. I think it's fair that the consumer should bear that burden. However, when they go beyond that and use it as a cash cow to be milked with the burden being cast largely on people outside the State, then I think it's unreasonable.

So, it's a matter of really determining what are the appropriate related costs borne by the State in the production. I think both Montana and Wyoming are capable of producing those figures.

Senator **Durenberger.** The last question that I've asked a lot lately, I might as well ask you. What do you think of Gene McCarthy running for the U.S. Senate? [Laughter.] You can strike the question and the answer. [Laughter.]

Mr. **Fraser.** I thought that was a good question. I thought we both might try to answer it. [Laughter.]

Senator **Durenberger.** Thank you, Don. I very much appreciate it.

Our next witness is the Honorable Mark White, the attorney general of the State of Texas. The State has been mentioned with a great deal of frequency in the first hour of our hearing. The attorney general has not been hesitant to share his opinions with people on severance taxes in his State.

I compliment you on the generosity of sharing your time with us up here in Minnesota. I hope that, during the course of the hearings we are conducting, we may be able to see you in Washington as well. I may, after you finish testifying, have reason to regret that invitation.

I thank you very much for coming, Mark. I look forward to your testimony.

TESTIMONY OF MARK WHITE, ATTORNEY GENERAL OF TEXAS

Mr. **White.** Senator, thank you very much for the opportunity to appear before your subcommittee on a matter which I think is of intense interest to this Nation and its people. I would like to say that Don Fraser and I were associated originally because I was a member of that National Coal Consumers Alliance, which is kind of a unique situation for a Texan to be. We didn't want to buy the coal in the first place.

Some of the thoughts, passed about here today, really point to the source of much of the problem we face with the 30-percent severance tax in Montana. One of the prior witnesses said, "Why don't we raise our severance tax on iron ore?" The response was, "Well, we've got a 4-percent tax now. If we raise it, we'll be pricing ourselves out of the market." Precisely my point. What I would like you to do is price Montana out of the market. The quickest way we can do that is to repeal the provision of the Fuel Use Act which requires people to shift from relatively accessible natural gas to the use of coal for the generation of electricity in our State in particular.

The State of Texas—about which I've heard much mention here today—seems to be doing quite well. As a member of the other group that is not doing quite so well, as a member of a group of the people of Texas, we have a lot about which to be concerned. No. 1, we are continuing to produce natural gas for the Nation at a much lower price than we've been permitted to buy it in our own State. I was interested to see the Northeast-Midwest Coalition here today. Maybe this is the beginning of a North—I can't determine exactly where Minnesota is except you're north of Texas, so I guess this is the North-South Coalition that may exist here today.

Senator **Durenberger**. Texas doesn't fall in any particular geographic area.

Mr. **White**. We get kicked out of every group we try to join. [Laughter]. We even tried to go back to Mexico a while back. All is forgiven; but they still didn't want us.

There is a book which I recommend to the subcommittee, by a Harvard University economics professor entitled "Energy Future." Once again, it may be strange for a Texan to be recommending a Harvard University book, but I think it does point out dramatically the need to go to the marketplace to solve most of our energy problems.

I, too, share the concern about the deregulation of natural gas, as pointed out in earlier testimony. Under the current deregulation program, Texans will be discriminated against most heavily—and I'm talking about the people of Texas. New York will be paying $1 per thousand cubic feet of gas, while Texans today are paying approximately $2.50 for that same natural gas.

We have seen the reclamation of these coal fields in the Northwest. Texans, as I assess it, are now paying reclamation costs for the price of the coal—because of the obligation of the coal producer to reclaim the land—through a Federal tax on it, and also through a severance tax. So, we have paid for the reclamation of Montana three times over. Frankly, what happens to the State of Texas in that environmental protection attitude is that they mine the coal in Montana but they force us to burn it in Texas. It is a very damaging commodity to our environment.

Basically what I would suggest to the subcommittee is that we should place a limitation on the severance taxes that a State can extract against the severance of minerals. The 12½ percent that has been selected, I submit, would be adequate on its face to pay for any damages associated with the severance of minerals from any State affected. I believe that one of the quickest ways—and frankly, today what we see is that the marketplace works amazingly slowly.

Today it seems that you can't find a single person in the State of Texas who is buying Montana coal or Wyoming coal or even coal from Colorado, even though they haven't raised their severance taxes. It is cheaper to buy coal from Poland and South Africa, put it on a ship, and deliver it to the coast of Texas than it is to buy it from our sister State of Montana. A combination of increased railroad rates and severance taxes have priced the American product out of the market. Today Texans are buying lignite in their own State rather than running the risk of being held captive by the legislature in Montana. When one of the members of their legislature stood before their assembly and referred to them—I believe it was—as "blue-eyed Arabs," no greater truth has ever been spoken.

Texas has a severance tax, which was alluded to today. That severance tax was last changed on natural gas back in the early 1960's, and on oil back in the mid-1950's. We have a 4.6-percent oil tax and a

7-percent natural gas tax. We have not, in the midst of the greatest energy crisis this Nation has ever faced, attempted to even raise either of those two taxes. At the same time, in the midst of that energy crisis, Montana and Wyoming, declaring in their legislature that "the Arabs have the oil; we have the coal," passed a 30-percent and a 17-percent severance tax, respectively.

I believe it's important for the future of this Nation that we do not declare economic warfare, one State upon another. I feel that the Texan is as endangered by the prospect of a Northeast-Midwest Coalition, as our Nation suffered over 100 years ago when we fought a split between the Nation over North and South. I believe the economic second war between the States is underway. I think this legislation would do much to put oil upon those waters and would do much to set this Nation's economic house back in order.

I'd be glad to answer any questions you might have.

Senator DURENBERGER. Thank you very much. By way of clarification, we did repeal the mandatory coal consumption section of the Fuel Use Act in the reconciliation resolution. If it sticks, we've helped you pour some oil or gas on some waters.

I went out to see the Governor of Montana a couple of months ago, and had breakfast with him to get to know him, and so forth.

Mr. WHITE. I think I got the attorney general reelected up there. Well, I'm not sure——

Senator DURENBERGER. I didn't bother meeting with him because he said some nasty things about me "coming disguised," and things like that.

The Governor said, "Well, we raised somewhere between $78 and $94 million on our little severance tax here last year, while Texas raised $1.5 billion." How do you handle that argument when it comes from someone other than the Governor of Montana?

Mr. WHITE. Well, quite frankly, we have a few more people in Texas than they do in Montana. We have five cities in Texas that are larger than the population of the State of Montana. I used to be able to say that we were a little larger than all the other States but Alaska has kind of taken that away from us. They remark how they can take their State, cut it in half, and make us the third largest State in the Nation. Sometimes I wish they would.

We have seen all of that economic income arise, not because of any legislative action in Texas, but because of economic action—whether it be through OPEC or just increased price levels for products. We did not ask for the price of oil to be elevated to $33 a barrel. No Texan has suggested that that was correct. Our legislature has not tried to take economic advantage because of the change due to international pricing cartels. For the same reason that he's saying we make a lot of money off our severance tax, we would not be buying his coal because of the increased price of oil.

Quite frankly what we have, and one of the things that the book "Energy Future" points out very well, is that if you will permit some modicum of free market interplay between the decisions about what energy source you use, it will tend to build some constraints in the marketplace. Just as you have a constraint on your severance taxes on mineral production, on steel or iron ore, Montana would have a constraint on their severance taxes to the extent that there are no longer people willing to buy their coal.

The bad problem there—and I think it defeats the national purpose—is that we, because of one State's greed, essentially lock up one of the largest natural resources in the energy field of this Nation. Coal, in its abundance in those two States, could largely make us independent of foreign energy sources within a relatively short period of time. That was the goal, and a worthy goal. That goal has been frustrated by two legislative bodies, the house and the senate in Montana and Wyoming.

Senator DURENBERGER. If we decontrol natural gas—which I guess I don't know where your congressional representatives stand on that issue. What I've heard about the——

Mr. WHITE. You can probably guess.

Senator DURENBERGER. I can probably guess. They did not say what you did when they were fighting the windfall profits tax about Texas' interest in letting OPEC set oil prices. If we decontrol natural gas prices, and the prices did what a lot of people predict they would do, it would seem to me that you might end up better off burning coal for electricity rather than decontrolled natural gas. Is that not possible?

Mr. WHITE. I think you're probably correct. In spite of the elevated prices of rail transportation, if we have to bear the burden of decontrol—and let me stress this point. Under the current law, decontrol will take place around 1985 or 1986. Even at that time there is no decontrol of pre-1977 interstate gas.

There's going to be some lucky fellow up in New York City who's going to be cursing Texas for sending this high priced gas to him. All the while, the people in Texas are going to be paying an even higher price for the gas because they will be—in a sense, New York—bidding up the price coming back into the market. They will be taking the old pre-1977 price, averaging their cost up, and still Texans will be paying a higher price for gas. I don't see any tears welling up in anybody's eyes in this room today.

The fact of the matter is, sure. You say that Texas is prospering by deregulation. The State will make money on deregulation. However, the people in Texas are going to pay mightily if we don't deregulate across the board. If it's going to be an evenly shared burden on all the people, then deregulation should be across the board. Otherwise, Texans are going to be, in a sense, subsidizing the gas market for New York. I don't think that's what the Congress really wants to do. I think we, too, often view this as being a Texas and Montana/New York and Minnesota problem when really it's a people problem.

The people in my State are paying the bills for this energy exercise that we're going through. The State of Texas, sure, profits on the severance taxes. Much of that money, let me say, doesn't go into a trust fund for future generations. That's what we're dealing with.

Senator DURENBERGER. I'd like to explore that and the people thing a little bit. We've dealt with the severance tax. Because of the unique way that Texas came into the Union, we're not talking about severance taxes on Federal oil or Federal gas in Texas. Is that right?

Mr. WHITE. That's right.

Senator **Durenberger**. Could you give me some idea, beyond the 4.6-percent severance tax which allegedly raised $1.5 billion last year in Texas, what other State and local revenues were generated from the extraction or the production of oil and gas in Texas? I take it there are royalties paid to the State of Texas on State lands? I didn't ask you this ahead of time so you may not be prepared to answer it. Can you give us the dimensions of the benefit to State and local governments, in some round figures, of the oil and gas production in Texas?

Mr. **White**. Well, on all oil and gas produced from State-owned land, the State has a royalty income. That royalty income would be in the neighborhood—I would think—of in excess of $100 million a year. The unique consequence which we came into the Union was that the State-owned land, at that time, did not cede to the Federal Government. We did for the assumption of the State debt at the time, or the country's debt at the time, give up territory which would have given us some pretty good coal land up in Wyoming. [Laughter.] The State laid claim to the land all the way up to Cheyenne.

Senator **Durenberger**. You mean Alaska could have been four States and we passed up the opportunity? [Laughter.]

Mr. **White**. But that's a historic consequence which is not likely to repeat itself.

The oil and gas revenues are a tremendous portion of our State budget. Our State budget this year will be, on a biennial basis, $26 billion. That is on a biennial basis.

At the same time we share burdens which are not shared by other portions of the Nation because of our boundary with Mexico and the population shift from Mexico into Texas. We, in recent court cases, have been required to pay out of our fund for the education of illegal aliens. So, there are a lot of complications and places to spend that money.

Senator **Durenberger**. Given that figure of $26 billion per biennium and figuring $12 or $11 billion for the first year of the biennium, can you give us a ball park percentage of revenue that is generated? A percentage of that total budget's revenue generated from oil and gas?

Mr. **White**. I think it's about 25 percent, possibly.

Senator **Durenberger**. About 20 or 21 percent of that comes from the severance tax and the balance comes from other taxes?

Mr. **White**. There are many taxing entities in Texas. We have over 5,000 taxing political subdivisions, and the ad valorem tax is the main basis for all other political subdivision revenues. The State is the only benefactor of the severance tax.

Senator **Durenberger**. To what degree does Texas share State-collected revenues with local governments and school districts in Texas?

Mr. **White**. The schools in our State are funded 90 percent of the minimum foundation program, which is supposedly the minimum amount of money to provide a quality education. Ninety percent of that is funded through State revenues. Ten percent funded by local support and any additional revenues they wish to contribute to educational efforts.

Senator **Durenberger**. Are there property taxes for local governments?

Mr. WHITE. Property taxes are the main support for all other political subdivisions in the State.

Senator DURENBERGER. Beyond the foundation aids to school districts, are there forms of property tax relief from the State level to city and county governments?

Mr. WHITE. The only property tax relief that we have has been a sharing of a 1-percent sales tax with the cities which have also passed a 1 percent. The State collects a 1-percent sales tax for the cities that have passed it.

Senator DURENBERGER. Now, you mentioned that there is no heritage fund as such. Does all of the revenue from the royalties and from the sales tax currently go into a general revenue for current operating expense and budget?

Mr. WHITE. They are set aside. Certain portions of it are set aside—such as, revenues off of certain school lands are set-aside for school purposes and most of that is income off of the corporates. I might say that this is not done in a fit of largess during the midst of the energy crisis. This was done when the second president of the Republic of Texas set aside a grant for the school children of Texas. Back in those days it was kind of an "iffy" thing whether there might be any school children down there or not. It turned out to be a very far-sighted decision made at that time in 1938—I guess it was.

Senator DURENBERGER. Your statement doesn't include it, but I think I've seen quotes from you—I think I alluded to one earlier—advocating that Texas raise its severance tax up to 15 or 16 percent. Do you want to add that to your statement?

Mr. WHITE. Yes. I have proposed that we study the possibility of raising the severance taxes in Texas. Right now Texas is the sole oil and gas producing State that has the lowest severance tax on oil and gas of all the other States. Every other State in the Nation has a higher severance tax on oil and gas than Texas does. I think Texans are being played for fools, if we're going to be forced to sit back and permit Montana to let us supply their treasury—as Minnesota is being called upon to supply the Montana treasury—with a 30-percent severance tax on coal, I reluctantly suggest that that is something which needs to be reviewed. I think it is a mistake that we be forced into economic self-defense. But to the extent that those are the realities of this country and there's no constraining force on any other State, then Texas should not be trampled upon by acts of other States.

To give you a quick example, you can say, "Well, why didn't Texas raise their severance tax to 30 percent?" The windfall profits tax has already forbidden Texas, or any other oil producing State, to pass through more than 15 percent of the increased severance tax on oil to the consumer. So, in a sense, you've already passed this bill for Texas. This bill already is applied on oil. Texas does not leap to the ceiling—in other words, has not gone to the 15 percent.

I do think that there is a significant threat for economic war between the States as a result of that Supreme Court case, with no constraints being placed on Montana. It locks up too much of the Nation's energy future because of one State legislature's excesses.

Senator DURENBERGER. I take it from what you said, you wouldn't have a problem extending the severance tax limitations? Even though we're at 12½ percent on Federal lands and coal now, you would extend the limitation to oil and gas if it were at the 12½ percent?

Mr. WHITE. No. I personally don't. I frankly don't see why we can't treat all of these resources equally and equitably.

Senator DURENBERGER. Is there a lower amount that you could live with than 12½ percent?

Mr. WHITE. I wouldn't suggest that at all. I think the 12½ percent level was suggested because Louisiana has a severance tax level of 12½ percent on oil, if I'm not mistaken.

Senator DURENBERGER. Texas does have the capacity—I don't know whether its problem is political capacity or what it might be—to tax oil and gas in the great degree it already has. I think you heard earlier testimony today about the role that Federal allocation formulas could play, perhaps, in alleviating some of these disparities among the States. Would it make some sense to you if we, at the Federal level—in looking at General Revenue Sharing formulas and a variety of other formulas—would take a close look at the fiscal capacity of a State to tax energy minerals, and reflect that in some of our formulas? What problems would you see in our doing that?

Mr. WHITE. I think you've already done this, and I think you've done it to the disadvantage of Texas. You did it in the low-income energy assistance program when funds were more readily available to those people who live in colder climates. The effectiveness of the Northeastern block of States is evident in that legislation.

I have supported Senator Bentsen's bill which would have equalized those energy grants. In spite of what our Governor in Wisconsin said about never hearing about anybody dying from being too hot, there were 1,400 Americans who died last year from overheating. This directly relates to energy costs which they couldn't afford. I think that anytime we treat one American in Maine significantly different than we treat an American in California—on the Federal Government level—we should be very careful in endeavoring to do that, because you ought to be an American whether you're in Maine, or California, or Texas, or Florida.

There's a little fight right now with our Department of Agriculture over the effectiveness of the medfly eradication program. They're giving Japan a better deal than they're giving Texas.

Senator DURENBERGER. I have one last question with which I think you might be able to help us. We have, here in Minnesota, a sort of a firsthand illustration of some of the fiscal disparity problems. We know a lot of Minnesota businesses go to Texas. We sort of don't mind that as much as we mind what seems to us to be some of the less fair competition that takes place between our neighbors just to the West of us who have substantial energy resources. We've got an awful lot of border problems in Minnesota with businesses and people leaving and going over.

I was asked when I was up there, "Can you think of any other comparable situations in this country?" The only other thing that occurred to me which might be comparable was Texas and Arkansas. I'm wondering if there is some comparability there? In effect, Arkansas being the Minnesota and Texas being the North Dakota with 25 or 26 percent of its budget being funded out of energy minerals, while Arkansas has more difficult problems funding some of its public services.

Mr. WHITE. The last time I talked to the attorney general of Arkansas and some of the people there, they were more interested in beating Texas on the football field than they were over any energy problems associated between the two States. Really, for some reason I don't think that we really share a diversity or animosity over that. I don't know why. Maybe it's because we're close neighbors. I think that maybe Minnesota and Texas are close neighbors here today.

Senator DURENBERGER. I thank you very much for making us seem closer. Thank you for taking the time to come out, to give your testimony and to respond to questions. We appreciate it a great deal.

Mr. WHITE. Thank you very much.

[The prepared statement of Mr. White follows:]

REMARKS OF MARK WHITE, ATTORNEY GENERAL OF TEXAS, BEFORE THE COMMITTEE ON GOVERNMENT AFFAIRS, SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, MINNEAPOLIS, MINNESOTA, AUGUST 31, 1981

Thank you for affording me this opportunity to address the implications to our federal system of state severance taxes. As you know, I have opposed what I feel to be excessive state severance taxes on coal production. At the same time, however, I have long championed the right of states to exact appropriate taxes upon minerals produced in their state. My concern, then, is that we not prohibit the right of states to tax, but that we place a constraint upon states which, pursuant to the Constitution, will prohibit states from inappropriately interfering with the goals of Congress and the nation.

I would like to confine my comments to the potential for abuse of an advantage created by natural circumstances, the potential for retaliation by other states, and the need for Congress to limit such abuse and retaliation while maintaining a proper deference by allowing states to maintain their integrity and independence regarding their internal affairs. First, I would like to speak to the importance of circumstance as that relates to severance taxes. In Texas, we have the makings of a heated debate as to whether or not we should raise our own severance taxes in light of the Supreme Court's holding in Commonwealth Edison v. State of Montana. Unfortunately, that debate probably will not consider the underlying rationale for imposing a severance tax, that is, the need to compensate the state for the loss of its natural resources and the damage incurred by the state in the act of removing those resources. Rather than consider whether Texas is adequately compensated by its present severance tax structure, the debate now focuses on one single issue: who will pay the increased tax? What should be a philosophical question then becomes one of simple fact: what percentage of minerals produced in the state is exported to other states? I assume that if the overwhelming majority of Texas oil and gas production was consumed in states other than Texas, we would raise our own severance tax. If, on the other hand, a significant portion of the minerals produced in Texas is consumed in Texas, we would be reluctant to increase our tax since we would perceive ourselves as paying a significant portion of that tax.

The narrowness of the Texas debate raises distinctions which are crucial to consideration of the bill before Congress. In enacting the energy policy of the previous Administration, the Congress intended to promote coal as a primary fuel source. In essence, Congress interfered in the marketplace and placed scarcely populated, but coal-rich, states in an advantageous position. Congress attempted to prohibit the use of certain fuels, such as natural gas, and at the same time, extended the mistake of price controls on interstate natural gas to the intrastate market and imposed controls on the price of crude oil produced in this country. That federal interference has left a legacy of distortion in the free market and has provided the means for a few states to reap undeserved benefits from us all. If the majority of their coal production is exported, the states are seldom reluctant to impose exorbitant severance taxes upon that production. Legislatures are quite willing to impose taxes which will be borne primarily by those not represented in the Legislature, who are not the focus of the Legislature's concern and who are incapable of constraining the Legislature's actions.

It is conceivable that retaliation by other states could occur. Experience indicates that retaliation, as well as the initiative itself, will occur when a state feels it can tax citizens other than its own. The early experiences of this nation operating under the Articles of Confederation indicated that such initiative and retaliation would destroy a nation. Accordingly, the framers of the Constitution attempted to avert such catastrophe. Unfortunately, however, the Constitution, as a device of prohibition, has failed to avert the problem when it arises as a result of circumstance. The Supreme Court has held that so long as a tax is facially uniform, it is unimportant that 90 percent of its incidence is on non-residents. On the other hand, the Court indicated that the Congress may use its constitutional power affirmatively to protect interstate commerce and prevent the abuse of self-interest and provincialism by placing a limit on coal severance taxation.

In the coal industry, a problem has arisen. By various actions, the Congress -- as well as economics -- has increased demand. Although we may differ as to what the congressional response should have been, no one can deny the purity of the congressional motive. The energy dilemma of the past decade is a matter of grave national concern. I do not advocate that the federal government interfere in the operation of states when those states are conducting their normal business. For example, I have consistently opposed the imposition of federal price controls upon intrastate natural gas. Certainly, taxation of local activities is a state's own affair. And equally certain, an activity which is interstate in character should not escape local taxation when it imposes costs upon the state and receives the benefits of the state government. Coal severance taxes, however, are rarely a matter of mere local concern. Much of the coal is produced on federally owned lands and consumed in the national market. Further, Legislatures in the taxing states are not constrained by having to face angry taxpayers located in the consuming states. In such circumstances, the states should be free to tax in order to receive compensation for the services they provide and the costs the activity engenders, but those states should be subject to the overriding national interest.

When the demand for coal is artificially increased, and when much of that coal is located on federal lands and is consumed in the interstate market, I believe that it is a proper -- and indeed necessary -- congressional response to place a limit upon the severance taxes states may impose on that coal production. The Congress, which represents all the people upon whose lands much of the coal is produced, is the proper body to act in the interests of all to protect against exorbitant and unreasonable tax rates. The Commerce Clause was designed to prevent economic balkanization, and the Commerce Clause certainly should provide the means and the spirit to keep the goods of the various states flowing among the various states and in the end, to keep this country prosperous and strong. If the states are allowed, through operation of circumstance, to restrict the free flow of goods between borders, our nation will founder upon the shoals foreseen by the founders. We cannot let this happen and I urge you to support a limitation on coal severance taxes.

Senator **Durenberger**. Our next witness is the Lieutenant Governor of the State of Minnesota, Lou Wangberg. We are pleased to have him here with us today.

I'm not going to ask you whether you're running the State. I can't recall if Al is at the National Governors' Conference or not. I do know of your concerns for the problems. You came to office from a part of the State which is now starting to experience, in the degree that I don't think we fully appreciate down here sometimes, the problems of fiscal disparities. I appreciate your being able to join us today and I look forward to your testimony.

TESTIMONY OF LOU WANGBERG, LIEUTENANT GOVERNOR, STATE OF MINNESOTA

Mr. **Wangberg**. Thank you. I guess the absence or presence of the Governor is something that goes on in enough of a routine manner, so I really hadn't thought of the Governor in more than two ways.

Good afternoon, Senator Durenberger. I'd like to welcome you and thank you for bringing these deliberations personally to Minnesota, and for your interest in hearing our State's concerns about severance taxes.

You've heard a lot today about severance tax philosophy and its consequences. I wish to add Minnesota's views to the discussion. It is an understatement to say that it is a complex issue. However, it is one that I personally believe may be as fundamental to some of the things which are going to happen in the future of interstate relations as any other subject that I can think of.

We firmly believe in the right of the States to levy severance taxes as reimbursement for the depletion of a State's natural resources. Minnesota levied a 4.89-percent severance tax on taconite which generated $88,484,000 in fiscal 1980. This money has been instrumental in mine land reclamation and in improving the quality of life on our Iron Range. Severance taxes, therefore, play a legitimate role in providing funds for: (1) environmental reclamation; (2) addressing problems of boomtown economies; and (3) providing for the future economic stability of a resource-producing region after these resources have been depleted.

Recently, energy severance taxes have escalated dramatically. It is time to analyze whether they are merely reimbursement for resource depletions or if they are creating a national economic schism between energy-rich and energy-poor States.

Minnesotans pay a high price for other State's severance taxes. Our price of coal, for example, is 10 percent higher because of these taxes. This resulted in $22 million of Minnesota money going to other States in 1980. Of this, $20 million went to the State of Montana alone. The bill for petroleum severance taxes is even higher. In 1980 Minnesotans paid nearly $42 million on oil severance taxes to energy-producing States. An additional $22 million in severance taxes was paid for natural gas consumed in the State.

In a pure energy sense, Minnesota is a "net exporter" of energy dollars. If these dollars had been spent on goods and services in Minnesota, the Gross State Product would have been approximately $116 million higher, creating jobs and higher incomes for our residents.

If you examine the table that I've included with my statement dealing with the gross differences in 1980 severance tax collections to the four States, you'll see a rather dramatic pattern.[1] Minnesota's per capita severance taxes amount to $20.56 per capita. As a percent of total State taxes, that amounts to 2.6 percent. Our North Dakota neighbor's per capita was $66.86 in severance taxes, which amounts to 11.8 percent of their total State tax burden. In Montana the numbers are $120.40, amounting to 21.7 percent. The most dramatic of all comes in Wyoming where $234.89 per capita amounts to 27.2 percent of the total State taxes.

Facts like this put one State against another, particularly during times of rising energy costs. In fact, we face another challenge if natural gas prices are decontrolled. The amount Minnesota pays in severance taxes on natural gas may triple by 1985.

The problem is further complicated by shrinking Government revenues. It is especially difficult for States caught in a revenue crunch, like Minnesota, to watch States, like Texas, operate without corporate or personal income taxes because their severance taxes meet a large portion of their revenue needs. While energy-rich States are able to reduce or eliminate taxes, citizens of energy-poor States are being asked to contribute more to continue or maintain State programs.

Before the tax battle between the States escalates, we must calmly examine proposed options to diffuse the problem. The proposed 12½ percent cap in coal severance taxes is one way to correct the problem. For Minnesota and other energy-consuming States, this would be a welcome relief. It generates revenue for energy-producing States, yet does not overburden energy-consuming States that pay the price. It means a compromise for both sides.

A 12½ percent cap should be further examined, however, in light of Federal tax cuts to States and cities. We are all looking for ways to meet our budget demands. Several States currently tax their natural gas at rates lower than 12½ percent. As their budgets shrink, they may be tempted to raise their severance taxes to increase revenues. Energy-consuming States would thus pay much more than they do now.

In addition to the 12½ percent cap. Federal program formulas need to be reexamined and reevaluated with different treatment for energy-poor States as compared to energy-rich States. Programs like fuel assistance and weatherization need to provide more dollars to energy-short States and less to energy-long States.

Because of the complexity of this problem, Governor Quie and I propose that a conference of State officials meet to explore the appropriate role and level of State severance taxes on all natural resources, not just energy. Such items like agricultural land, minerals, timber, and water need to be discussed in regard to depletion policy. There are a number of tradeoffs that need to be looked at. This conference should further address the appropriate role of the Federal Government in addressing inequities identified by the conference.

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[1] See p. 292.

Our form of Government, federalism, is based on the concept that our Union of States was formed so that, through sharing both burdens and benefits, all might prosper. It's important for us to remember this principle in future discussions. We urge you to strongly consider S. 178 and other bills to end this tax battle between the States.

I might just add, as a personal observation, that we have a very unique form of Government in this country in federalism. It really is unduplicated in the rest of the world. Somewhere, in the way governments are put together, between perfect centralization and perfect decentralization, there is a long continuum. We've had a continuing battle since the late 1700's as to what is the appropriate role of the States on that continuum. We fought a major civil war over one of the issues which relates to that.

One of the things we did establish, clearly established, is that there is some point where the national interest transcends the State interest. I believe that's really fundamentally what's at stake here. It isn't just a simple self-interest that's involved. We have a fundamental constitutional issue that will ultimately be decided when this legislation is passed.

Senator DURENBERGER. Thank you very much, Lou. The consequences of this situation are apparent to all of us who have been in the Red River Valley, and who have watched sunflower seed processing plants go for tax breaks in other States.

Later in the afternoon I believe we're going to hear from the tax commissioner from the State of North Dakota. I don't know whether his statement includes comments that I have heard from his predecessor and others to the effect that business taxes, and so forth, don't really make all that much difference. It seems to me the Governor of North Dakota is in Minnesota and in the Twin Cities periodically telling businesses that it costs a lot less to do business in North Dakota.

I just wonder what your observations, in general, are on that part of the so-called business climate in Minnesota. It's not so much the high cost of Minnesota business taxes, but the comparative lower cost of taxation in our neighboring State.

Mr. WANGBERG. Well, I happened to go to college with the new Governor of North Dakota. I don't recall that he used to smile as much in college as he has since he's become Governor of North Dakota. I think he has a very desirable position because they are in a very favorable, competitive position to attract new expansion into their business environment.

In Minnesota we focus very often in our public debates on businesses leaving Minnesota. I think that that's an important issue; however, it may not be nearly as important as the issue of the businesses that are never here, the expansions that are never here, that never physically move here. They just simply start somewhere else, and we don't know if we would have ever had them. Clearly, North Dakota is beginning to have the kind of environment and climate that attracts the expansion of those kinds of businesses. It's very difficult to do an accurate statistical analysis as to where it begins and where it ends. If you go and walk up and down the main streets of Moorhead, East Grand Forks, and Breckenridge, you can see there's a dramatic difference if you walk across the border to Grand Forks, Fargo, and Wahpeton. I'm confident that this is as big a factor as any that could ever be envisioned.

Senator **Durenberger**. Did you attend the recent Lieutenant Governors' Association Conference?

Mr. **Wangberg**. Yes, I did.

Senator **Durenberger**. Did this subject come up there at all?

Mr. **Wangberg**. Yes, it did. My colleague and my peer in the State of Wyoming is a marvelous lady who bears the title of Secretary of State because the offices are combined, Thyra Thompson. She also is a Republican, as I am. She considers my position on this issue very un-Republican. We have continuing debates, and it's a sharp debate. I notice now, over three conferences, that the debate grows sharper with each one. There is a deepening schism between the energy-have States and the energy-have-not States.

Senator **Durenberger**. What is then, in your opinion, the solution? Governor Quie and I are going to have another conference in which we might have more schisms. Is there going to be something unique about your conference that might shed some more light on this process?

Mr. **Wangberg**. Well, I think that it will focus on the broader issue. We're not just talking about iron ore in one State and coal, gas, and oil in another State. We're really talking about all of the resources of all of the States. There are other resources that can be depleted every bit as surely as coal and oil can be. Perhaps we need to have some kind of forum where those are analyzed. Although I can't project what the wisdom might be, I can't help but believe there would be a broader wisdom that would be part of the policymaking.

Senator **Durenberger**. Is there a discussion taking place among Governors and Lieutenant Governors with regard to the Federal financing role in eliminating or modifying some of these fiscal disparities? When Ken Nelson testified earlier, he said that the only resolution that he could get through the National Conference of State Legislatures was one that relates to the Federal Government looking at its fiscal policies. They either do not recognize the existence of these disparities or they do not recognize the fiscal capacity that some of the States have and others do not. Do you have a sense that that would be a common ground for Governors and Lieutenant Governors to come together on, which steps back from limiting the tax, and which might be helpful to us?

Mr. **Wangberg**. I think it might well be. I think that if you're going to have a rational discussion, you're going to have to have the debate structured in such a way that there is room for people to deal with the many agendas that they may or may not have announced. If we simply try to get together on the one single issue, I'm not sure we'd get very far on that one alone.

Senator **Durenberger**. You can't have any losers.

Mr. **Wangberg**. That's right.

Senator **Durenberger**. We thank you very much for your testimony and your obvious concern.

Mr. **Wangberg**. Thank you very much, Senator.

[Mr. Wangberg's prepared statement follows:]

PREPARED STATEMENT OF MR. WANGBERG

Good afternoon, Senator Durenberger and members of the Subcommittee on Intergovernmental Relations. On behalf of Governor Al Quie, I would like to welcome you to Minnesota and thank you for your interest in hearing our State's concerns about severance taxes.

We have heard a lot today about severance tax philosophy and its consequences. I wish to add the State of Minnesota's views to the discussions.

We firmly believe in the right of states to levy severance taxes as reimbursement for depletion of a state's natural resources. Minnesota levied a 4.89 percent severance tax on taconite which generated $88,484,000 in fiscal 1980. This money has been instrumental in mineland reclamation and improving the quality of life on the Iron Range.

Severance taxes, therefore, play a legitimate role in providing funds for:

(1) Environmental reclamation;

(2) Addressing problems of boomtown economies; and

(3) Providing for the future economic stability of a resource-producing region after these resources have been depleted.

Recently, energy severance taxes have escalated dramatically and it is time to analyze whether they are merely reimbursement for resource depletion or if they are creating a national economic schism between energy-rich and energy-poor states.

Minnesotans pay a high price for other states' severance taxes. Our price of coal, for example, is ten percent higher because of these taxes. This resulted in $22 million of Minnesota money going to other states in 1980. Of this, $20 million went to the State of Montana alone.

The bill for petroleum severance taxes is even higher. In 1980, Minnesotans paid nearly $42 million on oil severance taxes to energy-producing states. An additional $22 million in severance taxes was paid for natural gas consumed in the State.

In a pure energy sense, Minnesota is a "net exporter" of energy dollars. If these dollars had been spent on goods and services in Minnesota, the gross state product would have been approximately $116 million higher, creating jobs and higher incomes for our residents.

The following table reveals the gross differences in severance tax collections in four states:

1980 SEVERANCE TAX COLLECTIONS [1]

	Per capita	As percent of total State taxes
State:		
Minnesota	$20.56	2.6
North Dakota	66.86	11.8
Montana	120.40	21.7
Wyoming	234.89	27.2

[1] The greater majority is coal and the source of this information is the U.S. Bureau of the Census "State Government Tax Collection in 1980."

Facts like this put one state against another, particularly during times of rising energy costs. In fact, we face another challenge if natural gas prices are decontrolled. The amount Minnesota pays in severance tax on natural gas may triple by 1985.

The problem is further complicated by shrinking government revenues. It is especially difficult for states caught in a revenue crunch, like Minnesota, to watch states like Texas operate without corporate or personal income taxes when severance taxes meet a large portion of revenue needs. While energy rich states are able to reduce or eliminate taxes, citizens of energy poor states are being asked to contribute more to continue or maintain state programs.

Before the tax battle between the states escalates, we must calmly examine proposed options to diffuse the problem.

The proposed 12.5 percent cap in coal severance taxes is one way to correct the problem. For Minnesota and other energy-consuming states, this would be a welcome relief. It generates revenue for energy producing states yet does not overburden energy-consuming states that pay the price. It means a compromise for both sides.

A 12.5 percent cap should be further examined, however, in light of Federal tax cuts to States and cities.

We are all looking for ways to meet our budget demands. Several States currently tax their natural gas at rates lower than 12.5 percent. As their budgets shrink, they may be tempted to raise their severance taxes to increase revenues. Energy-consuming States would thus pay much more than they do now.

In addition to a 12.5 percent cap, Federal program formulas need to be reexamined and re-evaluated with different treatment for energy poor States as compared to energy rich States. Programs like fuel assistance and weatherization need to provide more dollars to energy short States and less to energy long States.

Because of the complexity of this problem, Governor Quie and I propose that a conference of State officials meet to explore the appropriate role and level of State severance taxes for all natural resources, not just energy. Such items like agricultural land, minerals, timber, and water need to be discussed in regard to depletion policy. There are a number of trade-offs that need to be looked at. This conference should further address the appropriate role of the Federal Government in addressing inequities identified by the conference.

Our form of government—federalism—is based on the concept that our union of States was formed so that through sharing both burdens and benefits, all might prosper. It is important for us to remember this principle in future discussions. We urge you to strongly consider S. 178 and others to end this tax battle between the States.

Senator **Durenberger**. Our next witness is going to be Mr. Richard L. Shirley, director of excise taxes for InterNorth, Inc. As soon as Mr. Shirley has completed his testimony, we will take a short break for those of you in the audience who like to take short breaks, and for our court reporter who about 2 weeks ago, was subjected to about 4½ hours straight of recording questions and answers in this room.

Mr. Shirley, would you proceed please?

TESTIMONY OF RICHARD L. SHIRLEY, DIRECTOR, EXCISE TAX, INTERNORTH, INC., OMAHA, NEBR.

Mr. **Shirley**. Mr. Chairman, InterNorth is appreciative of the invitation to be here at this subcommittee hearing to testify on severance taxes. I just have a short prepared statement which I will read.

My name is Richard L. Shirley, director of excise taxes for InterNorth, Inc. I represent InterNorth, Inc., and its headquarters is located at 2223 Dodge Street, Omaha, Nebr. InterNorth is a diversified energy corporation employing 11,000 people throughout the United States and abroad. The corporation's business activities include acquisition, production, transportation, and marketing of natural gas, liquid and petroleum products; and production and marketing of plastic film, petrochemicals and antifreeze; natural gas and oil exploration and production; and the mining and marketing of coal.

InterNorth, Inc. supports the concept of limiting severance taxes as contained in S. 178 introduced by Senator Durenberger and cosponsored by many others. We state this support while recognizing that the imposition of reasonable severance taxes are a proper exercise of a State's taxing power. The problem which S. 178 addresses is the attempt to shift the burden of taxation to out-of-State consumers through the imposition of unreasonably high severance taxes on coal. Severance taxes substantially in excess of the costs incurred on the taxing State or its citizens for mining or other productions are simply an effort to tax citizens of other States for the benefit of the taxing State's citizens.

If these severance taxes are permitted to be imposed, substantial shifts of income occur toward the producing/taxing States and away from consumer States. Such fiscal disparities will undoubtedly lead to efforts to retaliate by consumer States in order to maintain relative position, which will lead to an interstate taxation war. For example, in response to Montana's 30-percent coal severance tax, Texas might retaliate with an increase in oil and natural gas severance taxes. Iowa and Minnesota might retaliate with a severance tax on grain. Georgia and Oregon might retaliate with severance taxes on lumber. Kansas might put a severance tax on wheat. The possibilities are endless. We do not view such action to be in the best interests of producers, consumers, States, the United States, or InterNorth and its family of companies.

While there has yet to be any successful State attempt to place excessive severance taxes on natural gas extracted from the ground, such taxes could well be imposed at any time. Consequently, we encourage the subcommittee to explore the possibility of limiting to reasonable levels all severance taxes imposed on energy sources extraction.

Thank you very much.

Senator DURENBERGER. Thank you very much. I understand you're mainly in the distribution business. It has been very difficult for us to get producing companies to testify on this whole question of severance tax limitations. Do you know why we might be experiencing this difficulty with some of the oil, gas, and coal producers? Do you think the producers generally oppose severance taxes?

Mr. SHIRLEY. I think that—this is my opinion now—producers are really not all that concerned about an increase in a severance tax or a new severance tax, at least as to natural gas now. Since natural gas is still controlled, producers are still regulated by the FERC. Pursuant to the Natural Gas Policy Act of 1978, any new or increased severance tax that comes down the pike is going to be reimbursed by the pipeline company. The pipeline company's customer ratepayer is going to pay that increased tax.

Senator DURENBERGER. As a practical matter, what does happen to the severance tax with regard to natural gas and oil? Can it all be passed forward through the pipeline company to the consumers? Or, are there cases where you, as the pipeline company, might get stuck for a part of it?

Mr. SHIRLEY. Taxation is my area of expertise; ratemaking is not. I'm not that familiar with the Natural Gas Policy Act of 1978. I do know there are certain types of gas that are treated differently, so I should probably not speak to that.

It's my general knowledge that tax increases and new taxes levied on producers of natural gas are almost totally passed on to the pipeline company.

Senator DURENBERGER. You may not be an economist either so you may not want to answer this one, but suppose we had immediate decontrol. Might the consequence of that be to make some producers or pipeline companies swallow a part of that cost without passing it on?

Mr. SHIRLEY. Probably the ratepayer more than anything.

Senator DURENBERGER. The ratepayer would still get it?

Mr. SHIRLEY. My top management is opposed—it's my understanding—to immediate decontrol.

Senator DURENBERGER. I'm pleased to hear that.

Thank you very much, Mr. Shirley, for your testimony.

Mr. SHIRLEY. Thank you.

Senator DURENBERGER. We'll now take a break and reconvene at 3:15.

[At this time a short recess was taken at 3:10 p.m. and reconvened at 3:20 p.m.]

Senator DURENBERGER. The hearing will come to order.

Next on our list of witnesses are two gentlemen who will testify on the subject of energy prices and the effect of price increases on the economy of Minnesota. The first witness on the panel will be Dr. Clarence Nelson, vice president of the Federal Reserve Bank of Minneapolis. He has recently completed a study which purports to show little economic impact from rising energy prices. He will be followed by Mark Mason, the director of the Minnesota Energy Agency. The Energy Agency has been making economic projections for Minnesota's energy future for several years and has come to a decidedly different conclusion than arrived at by Dr. Nelson.

Clarence, we are ready for your opening statement. Then, Mark, we'll immediately go to your statement. We'll hold our questions until you both have made your presentations.

TESTIMONY OF CLARENCE W. NELSON, VICE PRESIDENT AND ECONOMIC ADVISER, FEDERAL RESERVE BANK OF MINNEAPOLIS; AND MARK MASON, EXECUTIVE DIRECTOR, MINNESOTA ENERGY AGENCY

Mr. NELSON. Thank you, Senator. I appreciate being asked to present the results of my report, "The Regional Impact of Rising Energy Prices," which was published in June 1981 by the Federal Reserve Bank of Minneapolis. That report sought to examine the effect sharply rising energy prices might have on energy surplus and deficit States in the Ninth Federal Reserve District. However, it mainly concentrated on a couple of aspects of Minnesota's situation, with Minnesota being the leading energy deficit State in the district. Since copies of the report, errors and all, are published and available for anyone wishing to examine the details, my aim here will be to comment on the results and the essential logic of the argument.

I should note that for purposes of this presentation my remarks are somewhat streamlined from the submitted text.

My analysis leads me to two basic results. The first relates to the income transfer effects of rising energy prices—the effect that gives energy producers a larger share from those rising prices, and energy consumers a smaller share. My claim here is that the conventional argument overstates the true net transfer of income between States resulting from any sharp runup in energy prices.

The second claim from my study says that the adverse impact of a rise in energy prices on the relative competitiveness of plant investment in Minnesota, while adverse as most of us would have guessed, does not appear to be quantitatively great.

Some useful criticisms of my approach, including comments from the staff of the Minnesota Energy Agency, have posed some worthwhile alternatives to the premises I used in looking at these problems. While I have not yet finished reassessing my work in response to these comments, none of the results so far have altered my view about the essential base validity of the conclusions. So let me elaborate briefly on each of the conclusions.

Beginning with the income transfer between energy surplus and energy deficit States. Minnesota provides a good case situation for considering the effects of energy deficits since the State imports virtually all of its primary energy materials: coal, petroleum, natural gas, and nuclear fuel. In 1972, before the first OPEC price shock, payments for imported primary energy at points of entry to the State, according to my rough estimates, amounted to something over $900 million. When we talked about income transfers, that $900 million plus payment flow has nothing to tell us. Nor does that expenditure necessarily have any adverse connotations.

We buy stuff from outside the State; we sell stuff outside the State. Both flows, in a sense, represent funds willingly given up to the mutual advantage of both buyer and seller. The problem of income flow transfer arises when relative prices of what you buy and sell change—in situations in which total payments for an essential commodity, such as energy, grow larger in spite of cutbacks in the amount consumed. Hence, sellers end up with a larger share of these primary income flows.

In the case of Minnesota, between 1972 and 1978, payments for primary energy materials brought into the State went up from an estimated 1972 level of $920 million to a 1978 level of $1,660 million, reflecting the impact of the first OPEC price shock. Given Minnesota's total personal income for that period of $115 billion—in 1972 dollars—the so-calculated income transfer amounted to about 2 percent of the State's personal income over that 6-year span.

But that's not yet to the point of my results which suggests simply that such an estimate overstates the actual net transfer of income. To explain: When energy prices go up, every Minnesotan spends more on energy; but some Minnesotans also gain from an energy price increase.

Payments for imported energy materials get split into income shares going to participants who own, produce, process, and move energy materials, as well as to the governments involved through taxes. When there is a rapid rise in real energy prices, not all income shares swell proportionately. The crux of the experiment here is to imagine who benefits when energy prices surge. Royalty owners and State governments by their severance taxes will tap off some fractional share. Between the two, that share has typically run somewhere between 10 and 20 percent. Montana's coal severance tax, as we've been reminded frequently today, runs 30 percent of the gross revenue at the mine mouth. Other State and local taxes may capture a bit of that payment surge via its impact on producer income and property values. However, as much as three-fourths of any price driven surge in revenues would fall to oil, coal, or gas producers. To be sure, the Federal Government cuts into that flow with its claims, mainly corporate income taxes, and its oil windfall profits tax. Whatever the Federal

Government doesn't tap off will accrue largely to the stockholders of energy producing companies—mostly major national corporations.

If then Minnesota's shares in the stockholdings of these energy corporations and its share in the government benefits supported by the Federal tax take are approximately equal to its share of population and energy expenditure, then Minnesota's income and benefit flow will also increase as a result of increased energy prices. The offset will be appreciable, perhaps half of the gross outflow.

Thus, my claim is that because of the income reflow, net income transfer over the span of 1972 to 1978 was closer to 1 percent of the State's real personal income than the 2 percent figure I had calculated crudely earlier. As a corollary of that conclusion, the net amount transferred from Minnesota to the energy producing States in the United States was even smaller, somewhere between a quarter and one-half of 1 percent of Minnesota's personal income. The remainder is accounted for by the drain-off to OPEC and other foreign producers.

Note that I've not dealt with here nor attempted to evaluate the secondary spending effects—the so-called multiplier or ripple effects. My focus is on the initial splash. The bearing my observations would have on the broader picture of income and spending consequences is simply that if the initial splash is, in fact, smaller, the ripples ought also to be smaller.

Above all, my argument is not that adverse income redistribution does not occur in the wake of sharp runups in energy prices. Income does, indeed, get redistributed when the real price of energy goes up. However, only a small part of that results in redistribution along the lines of the State geography, per se—from energy-importing States to energy-exporting States. The bulk of real income transfer occurs along the lines of class or wealth holdings. To draw a metaphor from the local oil payments, the sheiks dwell not only in Texas, but in Minnesota as well as the other energy deficit States. That's why, in my view, most of the widely publicized estimates of State energy dollar deficits do greatly exaggerate the net amount of payments effectively transferred between importing and exporting States as direct income shares in the energy supply process.

To move on to my second major conclusion, the effect of rising energy prices on comparative investment attractiveness of Minnesota for plant location is less than one would gather from what one commonly reads and hears. It's widely accepted that Minnesota is likely to be made worse off on that score than, for example, locations nearer to energy production and locations with a more congenial climate. Rising energy prices will, of course, hurt the profitability of energy-consuming businesses everywhere.

My study set out simply to generate some quantitative measures of how much more rising energy prices would hurt profitability in Minnesota than in some more preferable location. In my paper, I set up a hypothetical plant investment with features appropriate to Minnesota conditions, and to alternative, more favored locations in Texas or Louisiana. The idea was to look at a plant investment prospect with financial details tailored to the special conditions of each location. From the projected cashflow stream—then constructed—a rate of return on investment was calculated and used as a measure of comparative profitability.

My approach here was to attempt to identify those factors that might explain why a Minnesota location should be made worse off than some other location by a rise in energy prices. Three factors were suggested by a cursory review of some of the recently published discussions. First, that Minnesota's climate may require higher capital and operating outlays than would an otherwise identical operation in a more congenial climate zone; second, higher delivered costs of energy due to long transportation links might adversely affect the Minnesota location compared with locations at or near energy production sites; and, third, fiscal windfalls to major energy surplus States could adversely affect business tax burdens in Minnesota relative to those other States.

Now, if you'll turn to the bar chart handout, you'll see the results of separate experiments conducted for each of those three factors.[1] In each experiment for Minnesota against the alternative sites, I first assumed a base price for energy appropriate to 1978 industrial cost conditions of a $1.50 per million Btus. I then computed rates of return as represented by the left-hand bar in each bar pair. I then assumed the base price of energy was raised by half to $2.25 per Btus. I recomputed the rates of return as represented by the right-hand bar in each bar pair.

Let's look at each factor experiment individually. The climate experiment imposes on the Minnesota location a 14-percent greater energy operating requirement and a 4-percent greater capital investment than is true of the other two sites. Furthermore, the plan modeled is highly energy intensive, as Minnesota manufacturing industry goes, using 60,000 Btus per 1978 dollar value added. As you can see on the climate experiment at the top of the page, the rates of return dropped for each location with the 50-percent jump in energy prices. But the important observation is that Minnesota's drop in rate of return was only 0.08 percentage points larger than that of Louisiana and not even that much—0.05 percentage points—as compared to Texas.

The second experiment looks at what you get when you add to the Minnesota energy costs a transportation charge of 50 cents per million Btus—assumed to go up to 53 cents when we raise the base price of energy. The additional affect on the spread is 0.06 percentage points against the Minnesota location.

Finally, the fiscal impact experiment incorporates nonenergy tax rate reductions for the Louisiana and Texas locations commensurate with an assumed 50-percent increase in their 1979 energy-responsive revenues for those States. That, of course, corresponds to my assumption on prices. The net additional effect on Minnesota's rate of return, vis-a-vis other locations, is a change of 0.08 percentage points in favor of Louisiana, and a change of 0.05 percentage points in favor of Texas.

Now, my interpretation of those rate of return numbers—and you're certainly at liberty to draw your own—is that they represent relatively small changes, surprisingly small, in expected profitability in the context of practical plant location decisions. The factors that make Minnesota worse off in a regime of rising energy prices make Minnesota only slightly worse off under the experiments I've described here and do not appear to me, in this setting, to raise major impediments to the comparative investment attractiveness of a Minnesota location.

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[1] See p. 321.

In closing, let me restate my major conclusions. First, the transfer of income between States that results in a sharp runup of energy prices, as is often calculated, overlooks an important reflow adding to the wealth of the deficit States.

Second, the adverse impact of a rise in energy prices on business competitiveness in Minnesota is not as quantitatively great as much popular discussion would suggest.

Thank you.

Senator DURENBERGER. Thank you very much for your presentation. Mark?

Mr. MASON. Thank you, Mr. Chairman. I'd like to introduce Mark Spur, who has coordinated a lot of our study in response to what the Federal Reserve Bank has given today.

In the spring of 1980 the Minnesota Energy Agency published its third biennial report. In that report, the Agency predicted that rising energy prices would have a dampening effect on our economy over the next 20 years, without conservation and alternative energy development. The reason given for declining output and employment was the rapidly growing payments for energy—payments that drained money away from our local economy and transferred it to energy producing States and nations.

Then in June of this year the Bank published a study which also discussed the "Regional Impact of Rising Energy Prices." In this study the Federal Reserve Bank reached a very different conclusion, quite obviously. In fact, it dismissed the concern over regional shifts in income due to energy price increases as "playing with funny numbers," and concluded that "prospective energy price rises pose no general threat to the competitive position of Minnesota's economy."

Well, we feel it is important to look into the discrepancies between the two points of view for two reasons. First, if Minnesota is, in fact, losing out to energy producing States and nations, the economic consequences will be very serious. Already OPEC oil price hikes in 1973 and 1979 have slowed economic growth in Minnesota and other States. Second, if substantial shifts are occurring between the States, Federal and State energy and economic development policies can help soften the negative economic effects. The Federal windfall profits tax, for example, could be used to return some energy payments from energy-rich to energy-poor States.

In our review of the Federal Reserve study, we recalculated their 1978 estimate of the net amount of income transferred from Minnesota to show the minimum we believe was lost. Then we took a look at what has actually happened in the recent past, 1978 to 1980, and forecasted what might occur then between 1980 and 1985. We believe this is a key step, which was overlooked by the Federal Reserve, because it allows us to see that what looks insignificant to them in 1978 is really a growing threat.

Next we analyzed what impacts the net income transfer has had and will have on Gross State Product, on personal income, and on unemployment—a step again ignored in the Federal Reserve study.

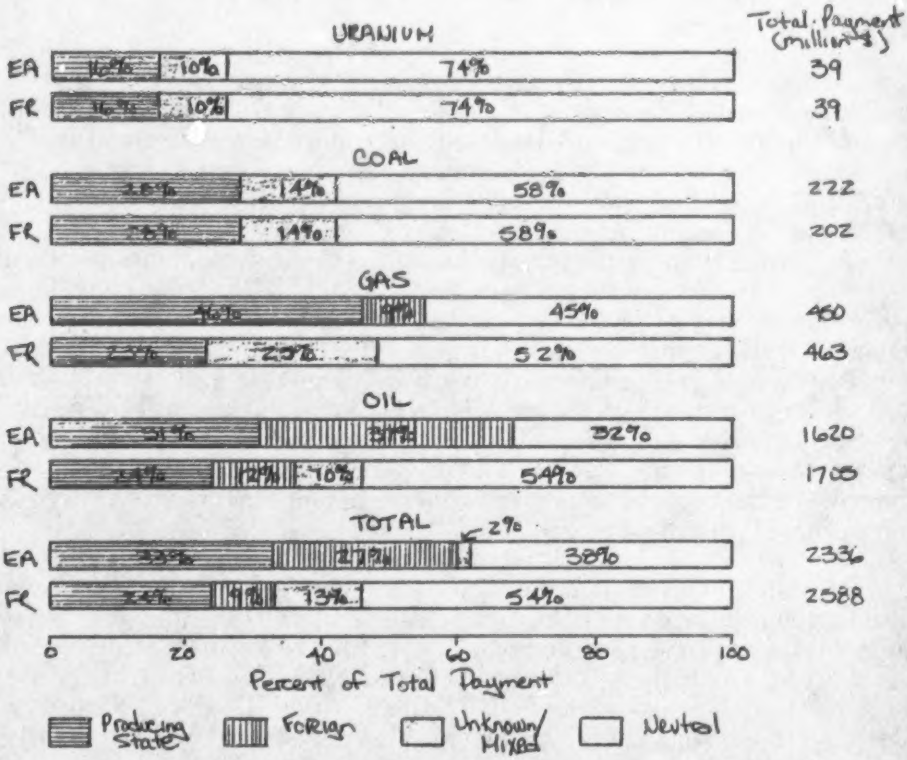
Although the Federal Reserve did acknowledge that output would be affected by rising prices, they failed to quantify how great the effect might be, making it easier to underestimate the importance of the transfer of payments.

Finally, we took a look at what was happening in the same period to the economies of energy-producing States to see if their Gross State Product, income, or employment was suffering similar effects.

What did we learn? First of all, the Federal Reserve rightly points out that, while all of Minnesota's energy payments leave the State, a certain portion certainly returns in the form of dividends to stockholders, Federal tax benefits, or payments to Minnesota industries that provide inputs into energy production elsewhere. However, our estimate of the amount of net income transferred, or that amount that does not return to Minnesota, is almost twice as large as the Federal Reserve's estimate, as you can see on this graph.

FIGURE 2

1978 Minnesota Energy Payments - Whose Income?
$ Estimates by Minnesota Energy Agency (EA)
and Federal Reserve Bank (FRB)

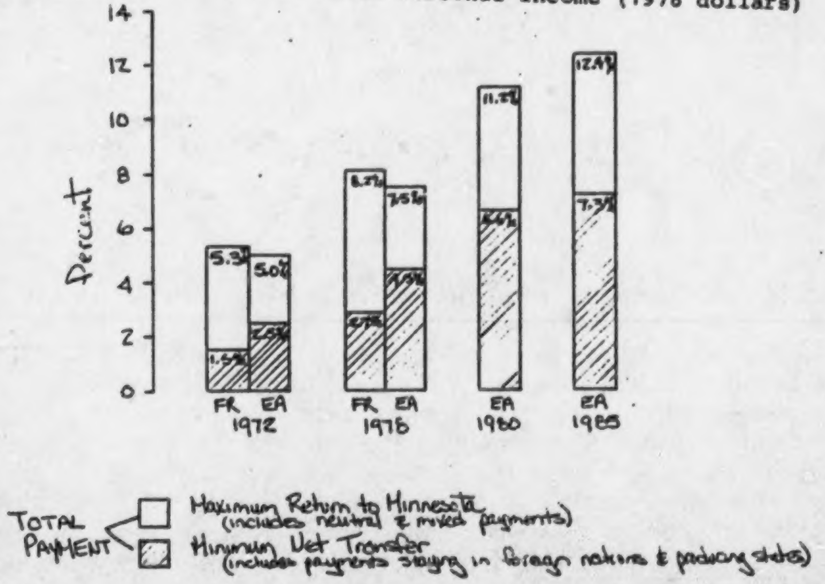


Mr. Mason. The graph shows you a flow of energy payments into four categories calculated by the Energy Agency and the Federal Reserve—EA and FR, respectively, on this chart. As you can see, uranium and coal were treated exactly as they were with the Federal Reserve. Large discrepancies can be seen in oil and gas payments, however, especially in the estimates of income transferred to foreign countries.

In sum, we show that 60 percent of the payments flow to producing States and foreign countries while the Federal Reserve estimate is about half as much—33 percent. The remainder of the payments are either neutral—that is, ultimately being replaced by payments back to Minnesota and mixed—or payments flowing to an indeterminate destination. Over time this net transfer of payments is becoming larger and larger in relation to our total net income. In other words, we're spending more and more each year on energy, relatively less on everything else, which is not surprising given that energy prices are rising faster than inflation.

FIGURE 3

Minnesota Payments and Income Transfers for Primary Energy Materials as a % of Total Personal Income (1978 dollars)



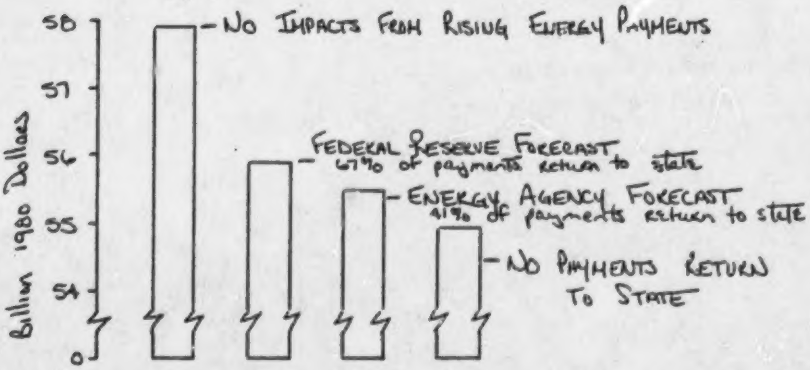
Mr. Mason. Our second chart shows the Federal Reserve's and Energy Agency's estimates of income transfers, the percent of our total personal income for 1972, 1978, 1980, and 1985. All estimates are made in 1978 dollars here. Between 1972 and 1978, income transfers grew from 1.5 to 2.7 percent of personal income. according to the Federal Reserve's study; and from 2.5 to 4.5 percent of personal income according to our analysis. While this growth does not seem like a particular trend, a more evident trend can be seen for the period between 1978 and 1985. Since 1978 we have already seen income transfer to other States and nations jump to 6.6 percent of our total personal income. By 1985 income transferred out of Minnesota for energy payments is projected to reach 7.3 percent of personal income.

Is this level of income transfer significant? Well, when energy payments are increasing faster than personal income, two problems arise.

One is that there is less money available to buy goods and services because more money is going to energy payments. Lower demand locally for goods and services reduces Gross State Product. The second problem is that there is a smaller pool of investment funds available because only part of our energy payments are neutral—that is, returning to the State to be reinvested. The loss of new investment funds further slows Minnesota's economic growth.

FIGURE 4

Effect of Income Transfer on Minnesota Gross State Product in 1985
- Four Scenarios -



Mr. Mason. Here we see projected Gross State Product in 1985 under four energy payments scenarios. The first is a baseline where there would be no effects of rising energy prices. The second shows the income and investment lost due to the kind of transfers of energy payments assumed by the Federal Reserve Bank. Under this scenario only 33 percent of the State's energy payments remain in the producing States or nations. Under the third scenario, the Energy Agency's higher estimate of income transferred, 59 percent in 1980, was used to calculate the economic impacts. Finally, a worse case scenario was developed to show what would happen in 1985 if no energy payments returned to the State to be reinvested in the local economy.

Looking at this graph we can see that the change in Gross State Product in constant dollars from the baseline is significant, under both the Federal Reserve and the Energy Agency scenarios. In fact, the most important point here is not that there is such a large difference between the two studies, which there is, but that both sets of assumptions indicate a significant slowing of economic growth by 1985. A 3- to 4-percent difference in Gross State Product translates into at least 76,000 fewer jobs than there would have been, and $1.6 billion less in personal income. A 3- to 4-percent change in Gross State Product in 1 year represents a loss of more than 1 year's growth in the economy and certainly sets the stage for recession.

Yet the Federal Reserve Bank dismissed the loss of energy payment to other States as too small of a matter. This is a shortsighted view that can be attributed in large part to using only 1978 data. Without looking at the past 2 years, 1979 and 1980, and without attempting to forecast into the near future, the Federal Reserve has failed to grasp the magnitude of the problem.

Isn't it happening everywhere? That's one of the questions that we posed.

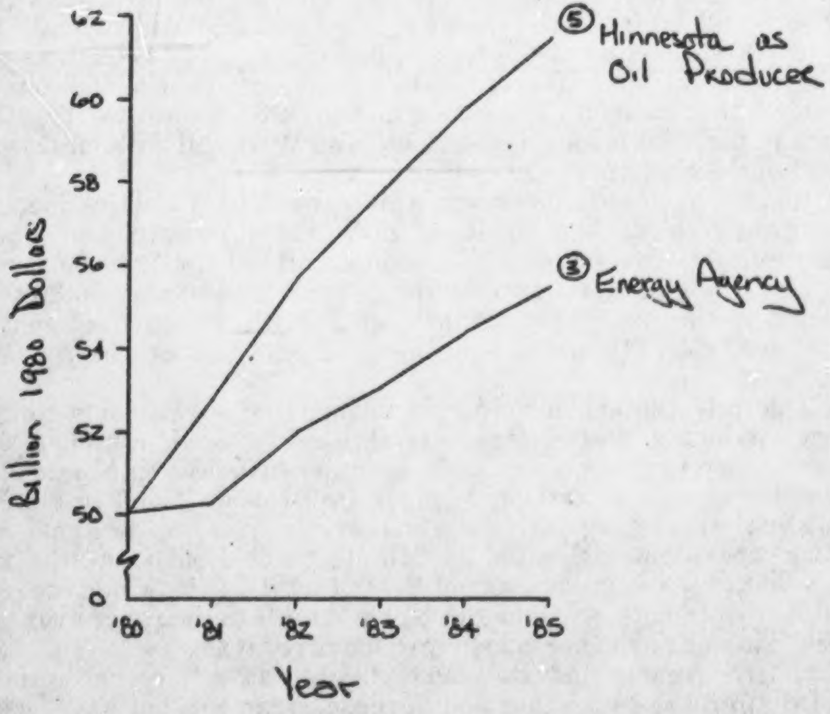
The Bank contends that, whatever the economic effect, everyone is getting an equal share of the energy payments' problems. After all, energy prices are rising everywhere, and this is correct. The reduction in consumer buying power due to rising energy prices is just as great in Texas as it is in Minnesota. You probably wouldn't see much difference in the prices people pay.

But what about that share of Minnesota's energy payments that is transferred into income for the producing States? Not only does such a transfer reduce Minnesota's investment pool, it increases the investment pool available to energy-producing States. This means higher income and ultimately more jobs for the energy producers. The income transferred in this manner to producing States thus counterbalances the negative effect of higher energy prices on the local energy-producing economy. Gross State Product continues to rise despite the energy price increases.

FIGURE 5

Projected Gross State Product 1980-1985

with Minnesota as oil producer



The next graph shows what would happen to Minnesota's Gross State Product if Minnesota could produce all of its own oil and gas. To examine this case we assumed that, starting in 1981, Minnesota started producing enough oil and gas to exactly meet its energy needs. In order to model this case, the mining sector of the economy was allowed to grow as if there were a local supply of oil and gas to supply Minnesota's demand. Prices were held the same as in the other scenarios. The results, a large increase in Gross State Product, mirrors what is actually happening in States like Texas.

TABLE 5.—GROWTH IN THE SOUTH AND WEST WILL CONTINUE TO OUTPACE OTHER REGIONS

[Average annual percent increase]

	Manufacturing employment		Real personal income	
	1971–80	1981–90	1971–80	1981–90
Northeast and Midwest	−0.1	0.6	2.1	2.4
New England	1.3	.7	2.4	2.5
Mid-Atlantic	−.9	0	1.3	2.2
East North Central	−.3	.7	2.4	2.4
West North Central	1.7	2.1	3.3	2.8
South and West	2.4	2.6	4.5	3.2
South Atlantic	1.4	2.2	3.9	3.2
East South Central	1.3	2.8	3.9	3.8
West South Central	3.7	2.9	5.8	3.1
Mountain	4.8	3.4	5.7	3.8
Pacific	3.3	2.6	4.3	3.0
Total, United States	1.0	1.6	3.3	2.8

Data: Chase Econometrics, Business Week.

The next graph before us, we can see, is a comparison of growth in the South and West to growth in the Northeast and Midwest over the past 10 years. Looking at the region, including Texas, growth in personal income has been 5.8 percent per year. In our part of the country it's more like 3.3 percent. Projecting into the next decade, we'll see that growth in personal income in the South and West will still outdistance the rest of the Nation.

Is there a connection between this growth and energy income? We certainly think there is. Right now energy industries are much more profitable investments than almost all others, including such high growth industries as computers. Thus, investment dollars are attracted to the energy-producing States. With a limited amount of capital available, Minnesota is losing out in the competition for these investment dollars.

Yet, despite the evident shift in income and investments toward energy-producing States, the Federal Reserve Bank contends that higher energy prices will not have a significant effect on Minnesota's competitiveness in attracting business investment. The Federal Reserve's analysis of competitiveness is flawed because the question is not whether one plant is located in Minnesota or Louisiana—the two States that they use in their example—but whether the whole range of possible investments in Minnesota is comparable to the range available in Louisiana or any other energy-producing State.

In sum, the Agency finds that the Federal Reserve Bank has initiated a useful approach to the question of income transfer, but has reached the wrong conclusions concerning the regional impact of rising energy prices. We differ with them on many individual assumptions; yet, even they have found that there is a measurable income transfer from Minnesota to energy-producing States and nations. Our estimate is that this income transfer in 1978 was about 60 percent of our total energy payments. They estimate only 33 percent. But with either estimate of income transfer, we found there was a significant dampening effect on this State's economic growth by 1985, a condition which can set the stage for recession. They did not even attempt to assess the impacts of rising energy prices on the Minnesota economy.

Finally, we found that the transfer of energy payments from Minnesota puts us at a disadvantage vis-a-vis energy-producing States in competing for investment dollars. In other words, the regional impact of rising energy prices is a large enough problem that it cannot be dismissed. Further study is needed to determine ways in which our local energy conservation and alternative energy development can help mitigate these effects. In addition, Federal and State energy taxing policies should be examined to insure that, at the very least, they do not exacerbate the income transfer problems of energy-poor States.

We believe that we have the resources in Minnesota—human, natural, and economical—to address many of these problems and come to grips with a lot of them. Obviously, we would need the help of Federal policies as well, such as what your subcommittee is examining, to deal with the interstate issues which have been discussed today.

The Minnesota Energy Agency believes conservation and alternative energy development are effective ways to counteract the negative economic effects of energy price increases in the State's economy. However, we no longer can afford to ignore the very real problems that are before us today. Thank you.

Senator DURENBERGER. Thank you very much, Mark.

Clarence, let me ask you to react to the Energy Agency's critique of your study in a general way, and then specifically with regard to that issue.

Mr. NELSON. Let me say that I see that they've accepted what was the essential point in my first findings. I notice that they have incorporated into their calculation of the amount of the net outflow for Minnesota.

I certainly don't dispute that secondary effects take place. I refer to that in my comments. I didn't look at those. That wasn't the objective of that portion of my study. I certainly agree wholeheartedly that that is an important and an interesting issue to look into. While I cannot—in this brief exposure I've had to the Energy Agency's estimates of these secondary effects and their projections—touch that here, I'm pleased to see that they've come out with a version.

Now, that's my general reaction. They bought what I consider to be the essential point, and that was the point.

The relevance, in some senses for your inquiry, is that if you're concerned about changes in State severance tax levels which would tend to shift this diversion more greatly in favor of the producing States, you've got to recognize that the issue of "who's helped and who's hurt" in this income transfer that takes place in the wake of a rising energy price is a good deal more complicated than just State A versus State B.

If you take an action that just sort of blanket transfers funds from Texas to Minnesota, you're going to be helping some of our wealthy citizens who don't need help, and are benefiting by this rise in energy prices; and you're going to be hurting some corporations in Texas who are consumers of energy and paying more for it just like we are. If you look at my chart,[1] you will note perfectly straightforward calculations there—just to demonstrate that both locations of industry are hurt. You're going to be adding salt to some people's wounds, and gravy to some people's well-stocked tables. I think that's the essential point.

As I said, the point I was making on that score—I don't want to get into this, but it appears to me that they have accepted our basic argument on this score. I think, in fact, they have done well in terms of delineating the kind of correct historical distribution of the payments made by Minnesota in 1978. I don't have any doubt that, in a number of respects, their estimates are better than mine and that they improved on mine, because I used a very stylized and—as they pointed out in subsequent phone conversations—an incorrect premise on that. However, it was strictly stylized to illustrate the point that the payment gets divided into a whole bunch of income shares. What I'm trying to extract now is the income shares.

I have just observed from the focus of this chart and the comments which were made, that the Energy Agency kind of misconstrues, doesn't seem to catch, the concept of income transfer about which I'm talking. They referred to this magnitude of the payments themselves as representing income transfer. It may take a little time to make the distinction very clear, but I think it ought to be clear.

My point is: When there is a runup in energy price—and I stated this—not all of these shares go up proportionately. The wage shares that are counted in there as going to Texas or the producing States, don't. They don't. I mean, what determines those wage levels is more significantly competition in the local labor markets. They don't get to glob on to the rents created by this surge in energy prices.

So they've essentially kind of missed the point there. I've got to take the blame, at least some of the blame there—or a lot of the blame for that. I did not write that second section in my report clearly enough; although if you read it carefully, it's there. I did kind of a poor job of explaining what I was really after, and I allowed too much to be focused on this breakout. I will freely declare they've certainly improved on my numbers on that score. However, as far as the basic result and conclusion of that section, from my point of view, that's left untouched by their argument. It still holds.

Senator DURENBERGER. Mark, do you have any brief reaction to that?

Mr. MASON. As you know, I'm not an economist so I should have my economist up here arguing with Dr. Nelson.

In response to one of the points here, it's perfectly obvious to me that we have a runup in prices in Minnesota. You also have a runup of prices in Texas as well. That's the price that people pay at the pump. You don't see an immediate adjustment in people's wages—obviously you don't. The question is: What's the cumulative effect of that runup in prices whereby so much of that money does not stay in our part of the country? It goes back to that State in terms of all the payments that go to the producing companies and gets reflected then into things like their tax structure and their overall investment climate. That's the point we're trying to make, in contrast to what the Federal Reserve had to say.

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[1] See p. 321.

Way back in our report in 1980, I think you'll find references to the fact that we recognized some of that money which flows out of Minnesota, in a primary sense, comes back to us. Clearly that's true. But the question is: What is the overall effect of things? Not only what is the overall effect at the point in time where you get rapidly rising prices, but do you have a trend that represents potentially great damage to the economy of a State like ours? I think the facts, from the standpoint of our analysis at least, are perfectly clear for Minnesota.

I might add that a report is being presented today at the Midwestern Governors' Conference in which various States—such as Illinois, Kansas, Iowa, Michigan, and others—did analyses like ours and reached similar conclusions.

Senator **Durenberger**. Dr. Nelson, wouldn't you agree that economic growth in the energy-producing States is much more rapid right now, and will continue to be much more rapid than in energy-consuming States?

Mr. **Nelson**. Sure, as you can notice from the table they showed us before, on the growth from 1970 to 1980 by all these regions. A lot of other things have been going on—as you well know—before this factor of energy prices was driving faster growth in some regions and slower growth in others. That's one of the things that has been going on. So what I'm just saying is, don't blame it on energy prices. Other stuff has been happening.

Now, how much additional effect does the energy price thing add? The Energy Agency has pointed out that as long as you've got energy prices going up faster than the cost of energy production—I take that to mean that somehow these submarginal resources in some of these energy-producing States would, when the prices go up, suddenly become profitable—we're going to see this growth going on. Obviously that's what's reflected in the big boom in exploration and development we're seeing today, and we hope it's going to yield a lot more oil. We favor that. That aspect of investment will be stimulated, but that's energy production.

Now, my experiment, in the last part of my study, was to ask: "Well, what about the poor sucker who's got to buy energy in Texas?" You know, my results show that even recognizing the fact of Texas' sharing in some sort of fiscal windfall through severance taxes and other energy price responsive revenues, there is only a minuscule change in the relative profitabilities between the two States in that hypothetical investment experiment in response to a 50-percent energy price jump.

Senator **Durenberger**. What are these other things that are going on in these energy-producing States? Aren't they all, in some way, related to energy wealth?

Mr. **Nelson**. My assumption—in the first place, you've got a lot of consumers who pay for this. It doesn't necessarily—I mean, they may work for banks or governments or teach school or whatever. They're going to be socked. OK. You've got a lot of companies producing goods that they export or sell in Texas—or wherever—which use energy as one of their inputs. This input in raw material, the price goes shooting up and it's going to have the——

What I'm saying is: Look. The impact is really diverse. You've got winners and losers, but you've got winners and losers in Texas; and you've got winners and losers here.

Some of the investment that's going to happen as a consequence of a surge in real energy prices, and the continued prospects for a rise in energy prices, is going to be in instrumentation, changing technology, and investment in conservation. This is the kind of thing—and I've got no reason to feel that that's exclusive to the energy-producing States. In fact, there ought to be as much incentive for firms located in the big deficit States. The fact that the relative price of energy has shot up has caused a lot of companies to suddenly wake up to kinds of investments they can make in their own plant—changes in their technology that can actually return very high rates of return.

OK. So that kind of thing—you know—is going to go on everywhere. We've certainly got some reason to think that some of the kinds of companies we've got in Minnesota, which produce instrumentation, controls, and computers, ought to get a little of that kind of expanded investment. The impact ought to rub off on them. There are a lot of things going on.

Senator **Durenberger**. I am not so much concerned about trying to pinpoint exactly what's going on, why, what's causing it, and where the costs and benefits are falling out with precision. I'm trying to understand what, it seems to me, is very clearly going on in this country right now.

As I look at the areas of economic growth and the areas of relative economic stagnation, it seems to me there's a direct relationship between those that have the capacity to produce needed energies and those that do not. There are some exceptions to that: Primarily in the South, and I suppose some that could be attributed to nonunion shops.

Generally, we can't argue with the fact that what is happening in Alaska, what is happening in Louisiana and in Texas and right here—what is happening in North Dakota and may be starting to happen in Montana. I just can't look at your graphs and translate that minuscule distinction you've drawn to what I see actually happening in those States. Yet, I have to deal with the practical problems of not being able to explain it. I suppose because I, too, am not an economist I can't demonstrate it. I need an economist so that I can then proceed to a solution. That's why we have studies to tell us exactly the nature of the problem so that we can proceed from there to a solution to that problem.

The reason you're here today, principally—and the Energy Agency is represented here today—is that two of the major stumbling blocks, if you will, to progress, or at least to building the level of concern for this problem, have been in the White House. There are those who believe that, since the Civil War, the South and the West have been the depressed parts of the country, and that we've had extreme fiscal disparities between the South and the West and all of the rest of us.

They believe that we have now closed that gap so that the country is relatively equal. They are going about the job of developing lots of responsibility to all the States in this country, feeling that there really aren't any disparities.

Locally, the pride certain people associated with the Federal Reserve—take in your study—demonstrates what I and a lot of other people have been saying, "That just ain't so." That is, Moorhead is dying, Breckenridge is dying, and other places are falling apart because of the consequences of energy production, pricing, and taxation in States to the west of us.

Now, I have read—I probably haven't read the fine print version of your report—but I've read the brochure version on my way out to see the Governor of Montana. We discussed your report. He hadn't seen it, but he was very interested in it.

It seems to me that the Federal Reserve, the Ninth District Federal Reserve, plays a rather unique role. It has a rather unique position to help all of us in these States deal with this problem. I think that's why it's important that we somehow draw either distinctions between your report and its conclusions and those coming from the Minnesota Energy Agency; or suggest that, if there are some common bases here, it would be worthwhile for you and the Fed to extend your initial analysis to some of the areas that Mark and the Energy Agency have reached out and put into this current study we see here today.

Mr. **Nelson**. I want to emphasize what I said before. There are lots of questions I haven't touched. I looked at very specific, special questions, and I'll stand by my methodology and my results. I think they're basically right.

However, questions about the impact of secondary effects are very important. Like I said, I didn't touch that. The Energy Agency has provided you with their ideas about some of these things that can happen. It is an area that we are interested in, and I am working to extend my study to properly accommodate a kind of complete, broad range of concerns which one would have to answer the question of what the regional impacts of rising energy prices will be.

Perhaps the title of my brochure may have been a little ambitious in the sense of the two special kinds of pursuits I made—to call it "The Regional Impact of Rising Energy Prices." A better way of titling it might have been to say "Some Aspects of Regional Impact of Rising Energy Prices." However, no one would have looked into it then.

Senator **Durenberger**. It probably wouldn't have been printed. Right?

Mark, do you want to react?

Mr. **Mason**. The difficulty here, Senator, is that out of a report like this we encourage public complacency. Certainly, as energy director in this State, I don't believe that we can be at all complacent about this problem and where it has taken us since it started to effect us in the early 1970's.

There are two points here I'd like to make. One is that we have to have national policies that are, at least, neutral in their effect on the various States when it comes to this energy question. I don't think we have that and I don't think we're moving in the right direction. The other thing is that we have to do those things at home that we can. One of those, obviously, is conservation.

The other thing to emphasize is that we can become energy producers. Some people have misconstrued that to say "The Energy Agency claims we can become energy self-sufficient." Obviously we cannot, at least in this century. However, the things that people are starting to do in Minnesota, and I think will do increasingly in the future, will reduce our reliance on outside sources. The involvement of the State and the private sector in this can make us into energy producers in terms of the resources we have on hand—whether we're talking about district heating, peat, wind, solar, and all the rest of these technologies which will be very important in our energy future.

Senator DURENBERGER. Dr. Nelson, let me just ask a couple more questions to clarify my understanding of your report.

First, just looking at it as an economist and not trying to make you a politician—what are your basic feelings about severance taxes and the exportation of taxes? Are we actually supporting all of the severance taxes through natural gas, coal, oil, and so forth? Is that good or bad? How do you feel about that as an economist?

Mr. NELSON. Well, my guess would be very much like the gentleman's from InterNorth. It probably is pretty easily passed along. This is not laying it into the framework of the academic studies which have looked at the issue and have said that probably nothing ever gets completely passed on. I would say most of the severance tax is just an add-on and ends up being paid at the pump, or at your local gas company counter, or wherever.

I don't pretend to be an expert in this area, but I think there are some rather fundamental questions about the notion of the severance tax itself. This probably has all the weight of a lay opinion, but it seems clear to me that at some high rate there is this phenomenon of a State exporting its taxes. Some of the benefits that have nothing to do with the production or the kind of restoration or disruption of the terrain, which goes on in the energy-producing State, are being paid for.

It seems to me that's sort of an obvious equity question. It seems to me it raises some deeper issues about the whole structure of taxation—State versus Federal—of the same sort that we've gone through in terms of community versus metropolitan area. You can get sort of bad effects through this chance distribution of the rent collecting power. So it seems to me there is kind of an equity case for some kind of a limitation on a severance tax.

Senator DURENBERGER. Let me ask you about the efficiency factor for the economy in one of the distinctions between Texas and Montana—that is, the heritage fund concept where the dollars are not coming back into the economy.

Mr. NELSON. I used to do a little bit of studying on our taconite industry—I've forgotten a lot of that—and I ran into that concept there. I guess I'm really kind of wondering if it makes any sense at all, from an economic point of view—this notion that here's a community left with a hole in the ground. This is the argument. You want to do something so that somehow the community, the population, the governmental infrastructure—that's the term—keeps on going after that mine is gone. If you're going to do it for exhaustible natural resources—it seems a logical question to me—why don't you do it for other kinds of activities? As you begin to pursue that, it kind of falls apart. Why would you want to do this? Why would we force some of our investment, channel it into—you know, where would it go if you didn't force it there? Someplace else in the economy where the return is higher. So what we're doing is bequeathing to future society a less efficient industrial plant, lower productivity, and lower wealth. So, what's legitimate, it seems to me, is sort of a restoration of the tax needed to cover the costs imposed by the mining or severance activity. However, this business of a heritage fund just doesn't make sense to me.

Senator **Durenberger**. The last question deals with the dating of the figures and the difference between $8.57 a barrel for oil, when 1978 figures are used, and $32 a barrel today. Is there value in updating the base upon which your analysis took place?

Mr. **Nelson**. Absolutely, and I'm doing that.

Senator **Durenberger**. Do you expect that that might show you something different?

Mr. **Nelson**. It's going to give you a bigger bang. I've already done a little of it. In other words, I've run through some experiments where I've changed the base price of oil, in this setup I've described, from $1.50 to somewhere in the neighborhood of $5 per million Btus. I think it brings it into the neighborhood of the 1980 and 1981 prices. It takes into account at least a big chunk of the second OPEC oil shock. I've got a lot more to do before I'm satisfied; however, I think the results are still basically small. It gets bigger but it doesn't show the kinds of large differences that Mark was pointing to here in his chart of these different industries with these differences in rates of returns.

The magnitude—I'll just mention that I got relatively small effects comparable to what I got in my initial study which totaled a .08, .06, and .08, I think they add up to .22. That is the total effect in adding up those isolated elements. I guess out of this higher price-level experiment—it is, in a sense, not for the record; I don't want to claim that this proves anything—I get a differential drop then between Minnesota and Louisiana for this model plant of about .41 and .45—someplace in that neighborhood.

Senator **Durenberger**. Well, part of the difference between the two of you is the difference between total return on investment and marginal return on investment. I don't want to get into that now because we'll spend too much time dealing with that.

Mark, do you have any final comments? There are a lot of questions we could get into.

Mr. **Mason**. I'm glad to hear about the recent updating of the Federal Reserve study to 1980–1981. The way it's been, I think their study is sort of like writing about American independence up to 1775. I mean, there is a lot that can be written up to 1775; but if you leave out 1776; there are important events left out.

I would make one other point too. We'd all have been better off if, in the Federal Reserve study, they had said, "We're examining some very special questions—very limited questions—and these are just experiments," and left it at that; but they didn't. They went on and generalized the whole situation.

Senator **Durenberger.** I don't think they intended it to be that way. That's the way it was characterized to me when the study first came out. This was the answer and it refuted all of the allegations. I know it's popular to pick on the Fed these days—and I don't want to make a loafer out of you, Clarence.

You didn't do it because I could see some of you in the report. I knew that there's a sense of humor there and there's a sense of accuracy in there—at least in the way that you've put that thing together—and I appreciated that.

My concern is for the way that others are characterizing your information, whether it was the title or whatever it was. A lot of people have been, at least temporarily, misled by the tentative conclusions of that report. I think that's why it's of a concern to a lot of us. I think this hearing today has helped all of us understand better some of the additional things we need to undertake.

Thank you both very much for your time, effort, and your concern for the subject.

[The prepared statements of Mr. Nelson and Mr. Mason follow. Mr. Mason's technical appendix can be found on p. 529.]

Preliminary Draft of Testimony by Clarence W. Nelson, Vice President and Economic Adviser, Federal Reserve Bank of Minneapolis, to be presented to the Senate Subcommittee on Intergovernmental Relations Hearing on Fiscal Disparities, State Energy Taxation and Tax Competition, St. Paul, Minnesota, August 31, 1981.

I've been asked to present the results of my report entitled The Regional Impact of Rising Energy Prices, published in June 1981 by the Federal Reserve Bank of Minneapolis. That report sought to examine the effect sharply rising energy prices might have on energy surplus and deficit states in the Ninth Federal Reserve District, but mainly concentrated on a couple aspects of Minnesota's situation, Minnesota being the leading energy deficit state in the district. Since copies of the report, errors and all, are published and available for anyone wishing to examine the details, my aim here will be to comment on the results and the essential logic of the argument—which is really quite simple.

My analysis leads me to two basic results. The first relates to the income transfer effects of rising energy prices—the effect that gives energy producers a larger share of the total of nominal income flows and energy consumers a smaller share. My claim here is that the figures for changes in a state's energy dollar deficit, as usually calculated, overstate the true net transfer of income between states resulting from any sharp run-up in energy prices.

The second claim from my study says that the adverse impact of a rise in energy prices on the relative competitiveness of plant investment in Minnesota as measured by its effect on expected rate-of-return, while adverse as most of us would have guessed, does not appear to be quantitatively great.

Some useful criticisms of my approach have been called to my attention and pose some worthwhile alternatives or extensions of the premises I used in modelling these problems. And while I have not yet finished revising my work in that direction, none of what I've seen alters my view about the validity of the key intuitions and conclusions in the report. It remains true that conventional analysis has overstated the between-states income transfer following a surge in energy prices, and on balance it is still the case that an energy price hike of fairly substantial proportions seems to generate surprisingly small rate-of-return consequences for the comparative profitability of Minnesota plant investments. But those extensions remain to be developed in a definitive way, so my aim here will be to give you a brief summary and explanation of the two basic results of my report as published.

I. Income Transfer Between Energy Surplus and Energy Deficit States

Minnesota provides a good case situation for considering the effects of energy deficits since the state imports virtually all of its primary energy materials (coal, petroleum, natural gas, and nuclear fuel). In 1972, before the first OPEC price shock, payment for imported primary energy at points of entry to the state, according to my rough estimates, amounted to something over $900 million. But when we talk about income transfer, that payment flow by itself has nothing to tell us. Nor has that expenditure any adverse connotations. We buy stuff from outside the state, we sell stuff to outside the state, both flows, in a sense, represent funds willingly given up to the mutual advantage of both buyer and seller.

Whether a relative price rise is good or bad depends on whether you're a buyer or seller. The problem of income flows transfer arises in the wake of real energy price changes because total energy payments by an importing state grow larger in spite of cutbacks in quantities of energy consumed. Sellers end up with a larger share of the income flows, hence greater relative command over whatever real output the economy produces for sale.

In the case of Minnesota, between 1972 and 1978 payments for primary energy materials brought into the state went up from an estimated 1972 level of $920 million to a 1978 level of $1,660 million (the latter figure is my estimate in terms of

1972 dollars) reflecting the impact of the first OPEC price shock. The cumulative real increase in payments over that span totalled $2500 million (1972 dollars). Given Minnesota's total personal income for that period of $115 billion (1972 dollars), the so-calculated income transfer amounted to about two percent of the state's personal income over the six-year span.

But that's not yet to the point of my result which suggests such an estimate, whether you express it as $2.5 billion 1972 dollars or as two percent of the Minnesota's measured personal income total, overstates the actual net income transfer.

The reason is that some of Minnesota's income and benefit stream is directly and positively related to the level of energy prices, and goes up in an offsetting way as real energy prices rise. Payments for imported energy materials get split into a set of direct income shares going to the various participants in production, processing, and movement of energy materials, including government tax shares. But when there is a rapid rise in real energy prices, not all income shares swell proportionately. The thought experiment here is to imagine who collects the economic rents when energy prices surge. By and large, I argue, those rents get collected at the well-head or mine-mouth end of the production process. Royalty owners by contract and state governments by their severance taxes will tap off some fractional share. Between the two, that share runs typically 10 to 20 percent. (Montana's coal severance tax, though, has been set at 30 percent of gross revenue.) Other state and local taxes may capture a bit of that payment surge via its impact on producer income and property values, but as much as three-fourths of any price-driven surge in revenues would fall to the oil, coal, or gas producer. To be sure, the federal government cuts into the flow by its claims, mainly corporate income taxes and oil windfall profits taxes. Whatever the federal government doesn't tap off, though, will accrue largely to the stockholders of energy-producing companies—mostly major national corporations.

If Minnesota's shares in stockholdings of these energy corporations and its shares in the government benefits supported by the federal tax take are approximately equal to its share of population and energy expenditure, then Minnesota's income and benefit flow will also increase as a result of increasing energy prices. The increase will offset in an aggregate sense a substantial portion of the increase in energy payments for Minnesota's energy imports. The portion of the total payment representing income transfer from Minnesotans as a whole to energy producing states' residents as a whole is very small—by my estimate somewhere between one-eighth and one-fourth of it depending on what share of the royalty payment claimants are located in the energy producing states. The incremental energy payment bulge untouched by producing state claimants (by my premises three-fourths or more of any price-driven surge in revenues less that drained off to foreign suppliers) is diffused broadly among stockholders of energy companies as dividend income or capital gains. Or some of it is diffused broadly among beneficiaries of federal services. Assuming Minnesota shares proportionately in these residual claims on the surge in energy "rents", then, by my rough estimate, around half the gross energy payment increase for Minnesota's imports is offset by energy price-related income and benefit flows. Assuming a 40 percent U.S. oil import ratio and no U.S. tax or stockholder share in payments to foreign oil producers, and roughly one-fourth of any surge in Minnesota's energy payment is drained off to foreign suppliers.

Thus, to return to the earlier calculation we made that the accumulated increase in Minnesota's out-of-state energy payments between 1972 and 1978 amounted to about two percent of the state's real personal income during that interval, my claim is that, because of the direct income share reflow, net income transfer over the span 1972 to 1978 was closer to half the two percent calculated share—or around one percent of Minnesota's total personal income. The net amount transferred to energy-producing states in the U.S. was even smaller, somewhere between a quarter and one-half of one percent of Minnesota's personal income over that interval.

Note that what I've talked about here are the primary, direct income-share effects from growing energy imports bills. I've not dealt with nor attempted to evaluate secondary spending effects, so-called multiplier or ripple effects. My focus is on the initial splash and the bearing my observations would have on the broader picture of income and spending consequences is simply that if the initial splash is, in fact, smaller, the ripples ought also be smaller.

Above all, my argument is not that adverse income redistribution does not occur in the wake of sharp run-ups in energy prices. Income does indeed get redistributed when the real price of energy goes up, but only a small part of that is assignable as a redistribution along the lines of state geography, from energy-importing states to energy-exporting states. The bulk of real income transfer occurs along lines of class or wealth holdings. To draw a metaphor from global oil payments, the sheiks dwell not only in Texas, but as well in Minnesota and other energy deficit states.

That's why, in my view, most of the widely publicized estimates of state energy dollar deficits greatly exaggerate the net amount of payments effectively transferred between importing and exporting states as direct income shares in the energy supply process.

II. Effect of Rising Energy Prices on Comparative Investment Attractiveness of Minnesota for Plant Location

The second thing my study sought to examine was the impact of rising energy prices on comparative profitability of business investment in Minnesota. It's widely accepted that Minnesota is likely to be made worse off on that score than, for example, locations near to energy production and locations with a more congenial climate from an energy use standpoint. Rising energy prices will, of course, hurt profitability of energy consuming businesses everywhere. My study set out simply to generate some quantitative measures of how much more loss of profitability might occur in

Minnesota than in some more favored location in the wake of a given percentage increase in real energy price.

In my paper, I set up a hypothetical plant investment with features appropriate to Minnesota conditions and to alternative, more-favored locations, which in my study were chosen to be either Texas or Louisiana. The idea was to look at a plant investment prospect with a 25-year future horizon: three years of plant construction outlays followed in the remaining years by positive net cash flows as the plant is operated. Cost details are tailored to the special conditions of each location. A rate of return on investment—the internal rate of return—is calculated from the projected cash flow stream and used is a measure of comparative profitability. For example, I first assumed a base price for energy appropriate to 1978 conditions of $1.50 per million BTU and computed a spread in rates of return for Minnesota and the alternative sight as indicated, for example, in Table 1, the first line. Then I raised the base energy price by half, to $2.25 per million BTU, and recomputed the spread between rates of return for the two locations as shown in the second line of the Table. The point of the various experiments I conducted within this general framework was to measure how much the Minnesota location's comparative disadvantage deteriorated under the assumption of a 50 percent increase in base energy prices.

The elements that give rise to differences in rate of return among three hypothetical locations I used include the following: differences in delivered cost of energy (e.g., because of additional transportation costs to Minnesota); differences in energy or capital requirements due to climate related factors; and differences in state and local taxes applying to manufacturing corporations in the respective three states.

The reason for incorporating state and local tax provisions is that in the final analysis, we are comparing expected after-tax rates of return. When energy prices change, so do expenses and taxable income, hence tax payments, cash flow, and rate of return. To gain a more correctly responsive measure of the effect of energy price change on rate of return, then, we need to incorporate state and federal taxes as elements. The formulas and bases for computing income, sales, and property taxes for each of the three states have been lifted directly from "Corporate Tax Climate: A Comparison of Sixteen States," published by the Wisconsin Department of Revenue in 1979.

My approach was to attempt to identify those factors that might explain why a Minnesota location should be made worse off than some other location by a rise in energy prices. Three factors were suggested by cursory review of some recent published discussions: (1) that Minnesota's climate may require higher capital and operating outlays than would an otherwise identical operation in a more congenial climate zone; (2) higher delivered costs of energy due to long transportation links could adversely affect Minnesota compared with locations at or near energy production sites; and, (3) fiscal windfalls to major energy surplus states could adversely alter business tax burdens in Minnesota relative to those states.

The study then attempted to isolate the bearing that each of the three factors would have on the way comparative rates of return between Minnesota and the alternative locations change in response to an energy price hike of 50 percent.

I've reproduced the rate-of-return calculations summarizing the three experiments as Tables 1, 2, and 3. The climate experiment imposes on the Minnesota location a 14 percent greater energy operating requirement and 4 percent more capital investment. Furthermore, the plan modelled is highly energy-intensive as Minnesota manufacturing industry goes, using 60,000 BTU per 1978 dollar value added. Even so, raising energy prices from $1.50 per million BTUs to $2.25 per million BTUs changes the spread in rate of return against Minnesota by only .08 percentage points in this experiment.

The second table summarizes what you get when you add to Minnesota energy costs a transportation charge of $.50 per million BTU (assumed to increase to $.53 when base energy prices is raised). The additional effect on spread is .06 percentage points against the Minnesota location.

Finally, the fiscal impact experiment incorporates nonenergy tax rate reductions for Louisiana and Texas locations commensurate with an assumed 50 percent increase in 1979 energy-responsive revenues for those states—that, of course, to correspond directly to the 50 percent energy price increase experiment. The net effect on Minnesota's rate-of-return vis-a-vis other locations is a change of .08 percentage points in favor of Louisiana and a change of .05 percentage ponts in favor of Texas.

My interpretation of those rate-of-return numbers—and you're certainly at liberty to draw your own—is that they represent relatively small, surprisingly small to me, changes in expected profitability in the context of practical plant location decision problems. The factors that make Minnesota worse off in a regime of rising energy prices make Minnesota only slightly worse off under the experiments I've described here, and do not appear to me to raise major impediments to comparative investment attractiveness of a Minnesota location.

In conclusion, I consider the results I've described to be suggestive, not definitive. But I think the report does contribute at least a few useful ideas to the debate about state energy problems.

Table 1

Climate Experiment Results
After Tax Rates of Return(%)

	Minnesota	Louisiana	Spread
Base Case	13.09	13.98	.89
Energy Price Increased 50%	12.10	13.07	.97

Table 2

Distance Cost Differential Results
After Tax Rates of Return(%)

	Minnesota	Louisiana	MN-LA Spread	Texas
Base Case	12.44	13.98	1.54	13.83
Energy Price Increased 50%	11.39	13.07	1.68	12.90

Table 3

State Fiscal Impact Experiment

	Minnesota	Louisiana	Texas
Base Case	12.44	13.98	13.83
Energy Price Increased 50%	11.37	13.13	12.93
Change From Table 2 Results	-.02	+.06	+.03

PREPARED STATEMENT OF MARK MASON

"Regional Impacts of Rising Energy Prices," Federal Reserve Bank of Minneapolis A Critique

Introduction

In the spring of 1980 the Minnesota Energy Agency published its third biennial Energy Policy and Conservation Report. In that report, the Agency predicted that rising energy prices would have a dampening effect on Minnesota's economy over the next 20 years. The reason given for declining output and employment was the rapidly growing payments for energy - payments that drained money away from our local economy and transferred it to energy producing states and nations.

In June 1981, the Federal Reserve Bank of Minneapolis published a study which also discussed the "Regional Impact of Rising Energy Prices."[1] In this study the Federal Reserve Bank reached a very different conclusion. In fact it dismissed the concern over regional shifts in income due to energy price increases as "playing with funny numbers,"[2] and concluded that "prospective energy price rises pose no general threat to the competitive position of Minnesota's economy."[3]

The question before us is which one of these studies is correct, or is there a grain of truth to both. We feel it is important to look into the discrepancies between the two points of view for two reasons. First, if Minnesota is in fact, losing out to energy producing states and nations, the economic consequences could be serious. Already, OPEC oil price hikes in 1973 and 1979 have slowed economic growth in Minnesota and other states.

[1] Nelson, Clarence W., "Regional Impact of Rising Energy Prices," Federal Reserve Bank of Minneapolis, June 1981.

[2] Ibid, p. 21

[3] Ibid, p. 20

Second, if substantial shifts are occurring between states, federal and state energy and economic development policies can help soften the negative economic effects. The federal windfall profits tax for example, could be used to return some energy payments from energy rich to energy poor states.

In our review of the Federal Reserve Study, we recalculated the Federal Reserve's 1978 estimate of the net amount of income transferred from Minnesota to show the minimum we believe was lost.

Then we took a look at what has actually happened in the recent past - 1978 to 1980 - and forecasted what might occur between 1980 and 1985. We believe this is a key step - overlooked by the Federal Reserve - because it allows us to see if what looks insignificant in 1978 is really a growing threat.

Next, we analyzed what impacts the net income transfer has had and will have on gross state product, personal income and unemployment - a step again ignored in the Federal Reserve Study. Although the Federal Reserve did acknowledge that output would be affected by rising prices, they failed to quantify how great the effect might be, making it easier to underestimate the importance of the transfer of payments.

Finally, we took a look at what was happening in the same time period to the economies of energy producing states to see if their gross state product, income or employment was suffering similar effects.

What did we learn?

First of all, the Federal Reserve rightly points out that, while all of Minnesota's energy payments leave the state, a certain portion does return in the form of dividends to stockholders, federal tax benefits, or payments to Minnesota industries that provide inputs into energy production elsewhere. However, our estimate of the amount of net income transferred, or that amount that does not return to Minnesota, is almost twice as large as the Federal Reserve's estimate.

Over time this net transfer of payments is becoming larger and larger in relation to our total personal income. In other words, we are spending more and more each year on energy, relatively less on everything else - a not surprising finding given that energy prices are rising faster than inflation.

As we will show, the economic effect of increasingly larger transfer payments from Minnesota to energy producing states is clear: growth in the state's economy will slacken, employment will be lower, and the state will find itself with fewer dollars for new investment - all the conditions of an economic recession.

The economic picture for energy rich states is much brighter as these states continue to benefit from being on the receiving end of our energy payments. These higher energy payments have helped the economies in the energy-rich states and have counter-balanced the economic impact of reduced consumer spending due to rising energy prices.

In sum, we found there really are indications of regional shifts in gross state product and personal income linked to higher energy prices. Minnesota is losing out in the competition for scarce investment dollars and, therefore, can hardly afford to turn its back on energy and economic development policies that can help compensate for the energy dollar drain.

Total Income Transfer Underestimated

In revising the Federal Reserve estimate of net income transfer, our first step was to calculate our total energy payments for both 1978 and 1980. Available data shows there was a significant jump in total energy payments between those two years. This change was due mainly to the huge price increases for petroleum in 1979. These price increases, however, did not figure in the Federal Reserve's analysis because they only looked at 1978 data - an approach that tends to underestimate the importance of the energy payments problem.

TABLE 1

Minnesota Payments for Primary Energy Materials
1978, 1980, 1985
(Millions of 1978 Dollar)

	1978		1980	1985 Projected
	FR*	EA*	EA	EA
Oil – Crude oil	1,887	947	1,296	1,644
Oil – Refined Products		652	1,438	1,621
Natural Gas	445	449	526	823
Coal	218	222	326	435
Uranium	38	39	41	44
Total Payments	2,588	2,336	3,627	4,567
Minnesota Personal Income	31,620	31,266	32,498	37,476
Payments as % of Income	8.2	7.5	11.2	12.2

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*
FR--Federal Reserve Bank
EA--Energy Agency

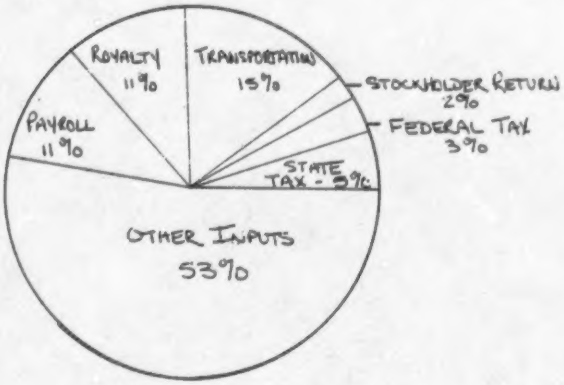
Energy prices are expected to continue to rise at rates higher than inflation - as seen in Table 1 - due to decontrol of oil and gas prices. So that by 1985, Minnesota's total energy payments will reach 12.4% of our total personal income, compared to only 8.2% in 1978 as calculated by the Federal Reserve.

Once the energy payments leave the state, where do they go? How many of these payments return to the state as benefits from federal taxes, stockholder dividends, or other payments to Minnesota business involved in the energy field? Minnesota buys coal, uranium, natural gas, crude oil and refined petroleum products. The payments made for each of these fuels can be broken down into the cost components, as is done in Figure 1 for oil payments.

FIGURE 1

Components of 1978 Oil Payments

(% of Total Payments/Deficit)



The cost components displayed in Figure 1 are, in effect, income shares that can be geographically distributed, as the Federal Reserve study attempts to do. We took a close look at the Federal Reserve's analysis of this geographical distribution, however, and made substantial revisions.

TABLE 2
Some Differences Between Federal Reserve
and Energy Agency Assumptions Regarding
Components of Payments for Oil and Gas

	FRB	MEA
Payroll	100% producing state	100% producing state
Other Inputs	33.3% producing state 33.3% neutral 33.3% unknown/mixed	70% producing state 30% neutral
State taxes	100% producing state	100% producing state
Royalties	100% unknown/mixed	75% producing state 25% neutral
Stockholders Return	100% neutral	9% oil, 27% gas producing state 91% oil, 73% gas neutral
Federal Taxes	100% neutral	100% neutral
Refinery value added	10% producing state 90% neutral	28% producing state 72% neutral
Transportation costs	100% neutral	30% producing state 70% neutral

Payroll - we both agreed - stayed in the hands of the employees in the energy producing states as do the state taxes.

Other inputs to energy production, however, were rather arbitrarily divided by the Federal Reserve into three parts - 33% staying in the energy producing state, 33% ultimately flowing back to Minnesota (called "neutral" income in the Federal Reserve study) and 33% flowing to an indeterminate destination (called "mixed" income in the Federal Reserve study.)

Since the "other inputs" category is so large, more than 50% of the total oil payments in 1978, we took a look at data on the inputs to the energy industry. Data from a model of the Texas economy indicates that almost 70% of payments made by the oil and gas production companies other than payroll, taxes, royalties or depreciation went to in-state companies.[4]

We assumed this pattern for Texas would be similar in other oil and gas producing states and applied 70% of the "other inputs" category to the producing state, significantly more than the Federal Reserve study assigned to producing states.

The Agency also disagreed with the Federal Reserve's assignment of royalty payments to the category of "mixed" income, i.e. income having a geographically indeterminate destination. Although there is only incomplete information available on royalty payments, just looking at Table 3 shows that, of those royalty payments made to individuals and states $2.86 billion went to six energy producing states - while only $6 million came to Minnesotans. A good portion of corporate royalty payments could be expected to flow to energy producing states as well. Therefore we assigned 25% of royalty payments to the "neutral" income category and assigned the remainder, 75% to the producing states.

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[4] Herbert W. Grubb, Ph.D., The Structure of the Texas Economy, Appendix A, Table 2, p. 108

TABLE 3

	Royalty Payments to Individuals and States (million $)	% Royalty Payments Payments to Individuals and States	% of Total U.S. Production of Oil and Gas
Texas	1,373	36.3	24.9
Louisiana	631	16.7	20.0
Oklahoma	342	9.0	5.2
California	241	6.4	4.4
New Mexico	143	3.8	5.2
Alaska	130	3.4	5.3
Total Oil and Gas Producing States	2,860	75.6	65.0
Minnesota	6	0.2	0.0

Stockholders' returns were seen as entirely "neutral" income by the Federal Reserve Bank - that is shared equally by everyone. Again, available data shows this is not true: in fact, 9% of the oil and 27% of the gas used in Minnesota actually comes from privately held companies located in producing states. Payments to these companies obviously cannot be considered "neutral" income.

Federal taxes, on the other hand, should flow equally back to all the states - so these payments were categorized as neutral in the Federal Reserve's and the Energy Agency's analysis.

Finally, we took a look at refinery value added - or the payments for converting crude oil to gasoline and other products, and the payments to transport the oil and gas to Minnesota. Again, the Federal Reserve Bank seems to have underestimated the amounts of these payments that go to the producing states, as discussed in the Technical Appendix.

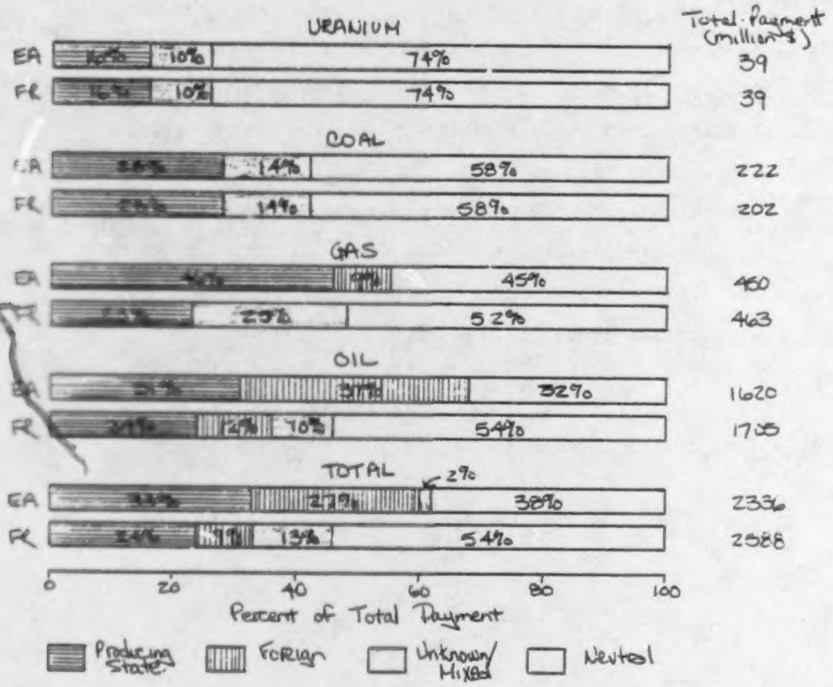
So far we have talked about domestic production of oil and gas. But what about foreign oil? Surely, it seems obvious that a large portion of these payments end up in foreign nations - and never return to Minnesota. Here, one conspicuous error in the Federal Reserve's study is their estimate of foreign income from Minnesota's payments for imported oil and gas. In 1978, 44% of U.S. oil was imported. Minnesota actually imported more than this, but the now defunct entitlements program had the effect of reducing our payments for foreign oil to the national average. The Federal Reserve Study, in effect, assumed that Minnesota actually imported no foreign oil. We estimate that at least 85% of Minnesota's payments for foreign oil stayed in the foreign nations, while the remainder could be considered neutral income. Similarly, about 7% of our natural gas came from Canada in 1978, and at least 85% of those payments stayed in Canada. The Federal Reserve study assumed we imported no gas from Canada.

The net result is that 37% of our total oil payments and 9% of our gas payments went to foreign nations - while the Federal Reserve report estimates that only 12% of our oil payments and none of our gas payments went to foreign nations. The Federal Reserve estimates do not match up, in this respect, with what actually happened in 1978, or with what is happening today.

The flows of all the component payments are summarized in Figure 2. Uranium and coal payments were treated exactly as the Federal Reserve study treated them. Large discrepancies can be seen in oil and gas payments, however, especially in the estimates of income transferred to foreign countries. In sum, we show that 60% of the payments flowed to producing states and foreign countries while the Federal Reserve estimate is about half as much - 33%.

FIGURE 2

1978 Minnesota Energy Payments - Whose Income?
% Estimates by Minnesota Energy Agency (EA)
and Federal Reserve Bank (FRB)

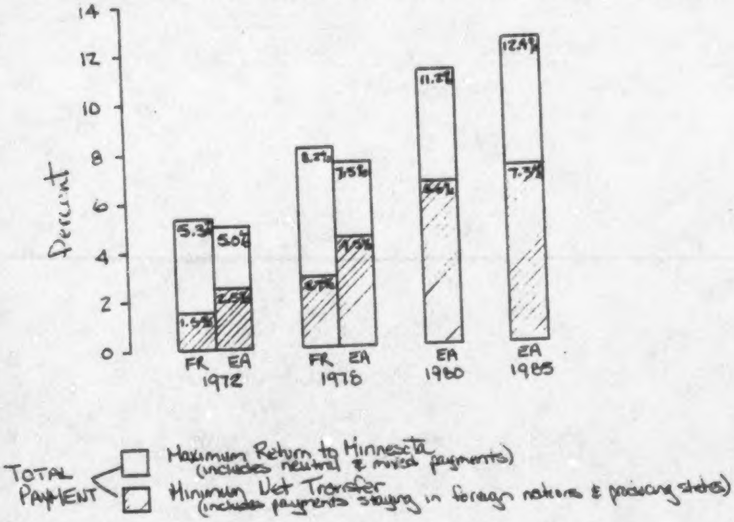


How does income transfer affect the economy?

Figure 3 shows the Federal Reserve and the Energy Agency's estimates of income transfer as a percent of our total personal income for 1972, 1978, 1980 and 1985. All estimates are made in 1978 dollars. Between 1972 and 1978, income transfers grew from 1.5% to 2.7% of personal income according to the Federal Reserve study, and from 2.5% to 4.5% of personal income according to the Agency's analysis. While this growth does not seem particularly threatening, a more evident trend can be seen for the period between 1978 and 1985. Since 1978 we have already seen income transfer to other states and nations jump to 6.6% of our total personal income. This jump is closely correlated with the rise in total energy payments and rising energy prices. However, the income transfer effect was somewhat lowered in this period due to Minnesota's declining use of foreign oil, and the effects of the windfall profits tax.

FIGURE 3

Minnesota Payments and Income Transfers for Primary Energy Materials as a % of Total Personal Income (1978 dollars)



By 1985, income transferred out of Minnesota for energy payments is projected to reach 7.3% of personal income, an increase of 4.8% from 1972.

Is this level of income transfer significant? When energy payments are increasing faster than personal income two problems arise. One is that there is less money available to buy goods and services because more money is going to energy payments. Lower demand locally for goods and services reduces gross state product. The second problem is there is a smaller pool of investment funds available because only part of our energy payments are "neutral" - that is, return to the state to be reinvested. The loss of new investment funds further slows Minnesota's economic growth.

Table 4 shows projected gross state product, personal income and employment in 1985 under four energy payments scenarios. The first is a baseline which assumes that there are no effects of rising energy prices on the economy.

The second scenario shows the income and investment lost due to the kind of transfers of energy payments assumed by the Federal Reserve Bank. Under this scenario 67% of the energy payments are considered neutral.

Under the third scenario, the Energy Agency's lower estimate of neutral payments - 41%, as calculated for 1980 - was used to calculate the economic impacts.

Finally, a worse case scenario was developed to show what would happen if no energy payments returned to the state to be reinvested in the local economy.

TABLE 4

Minnesota 1985 Gross State Product, Personal Income
and Employment as affected rising energy prices
4 scenarios

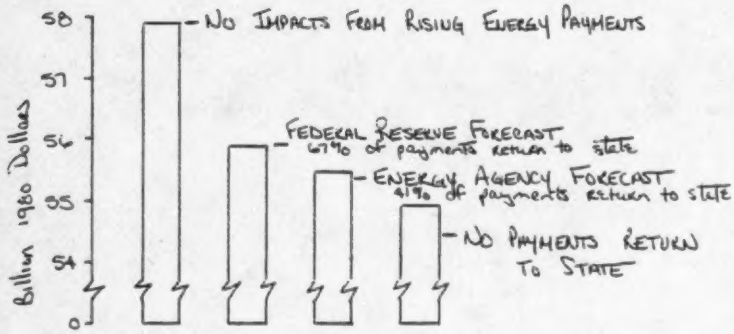
	1 No impacts of rising prices	2 Federal Reserve 67% of Payments Return	3 Energy Agency 41% of Payments Return	4 No Payments return
GSP billion 1980 $ (% change from 1)	57.9	55.9 (3.4%)	55.5 (4.1%)	54.9 (5.2%)
Personal Income billion 1980 $ (% change from 1)	45.8	44.2 (3.5%)	43.9 (4.1%)	43.4 (5.2%)
Employment Thousands of workers (% change from 1)	2225	2149 (3.4%)	2138 (3.9)	2120 (4.7%)

The change in gross state product in constant dollars from the baseline is significant - under both the Federal Reserve and the Energy Agency scenario (Figure 4). In fact, the most important point here is not that there is such a large difference between the two studies, but that both sets of assumptions indicate a significant slowing of economic growth by 1985. A three-to-four percent difference in gross state product translates into at least 76,000 fewer jobs than there would have been, and $1.6 billion less personal income. A three-to-four percent change in gross state product in one year represents a loss of more than a year's growth in the economy and sets the stage for recession.

Yet the Federal Reserve Bank dismissed the loss of energy payments to other states as too small to matter. This is a short-sighted view that can be attributed in large part to using only 1978 data. Without looking at the past two years - 1979 and 1980 - and without attempting to forecast into the near future, the Federal Reserve has failed to grasp the magnitude of the problem.

FIGURE 4

Effect of Income Transfer on Minnesota Gross State Product in 1985
- Four Scenarios -



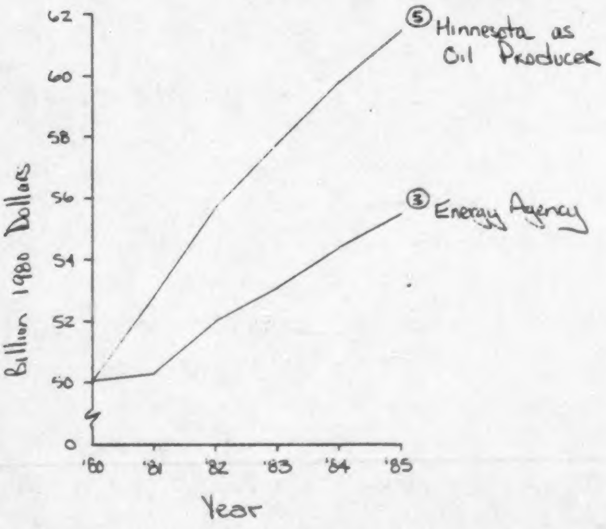
But isn't it happening everywhere?

The Federal Reserve Bank contends that, whatever the economic effect, everyone is getting an equal share of the energy payments problems. After all, energy prices are rising everywhere. This is correct. The reduction in consumer buying power due to rising energy prices is just as great in Texas as it is in Minnesota.

But what about that share of Minnesota's energy payments that is transferred into income for the producing states? Not only does such a transfer reduce Minnesota's investment pool; it increases the investment pool available in energy producing states. This means higher income and ultimately more jobs for the energy producers. The income transferred in this manner to producing states thus counter balances the negative effect of higher energy prices on the local - energy producing - economy, and gross state product continues to rise despite energy price increases.

Figure 5 shows what would happen to Minnesota's gross state product if Minnesota could produce all its own oil and gas. To examine this case, we assumed that, starting in 1981, Minnesota started producing enough oil and gas to exactly meet its energy needs. In order to model this case, the mining sector of the economy was allowed to grow as if there were a local supply of oil and gas to supply Minnesota's demand.

FIGURE 5
Projected Gross State Product 1980-1985
with Minnesota as oil producer



Prices were held the same as in the other scenarios. The result - a large increase in gross state product - mirrors what is actually happening in states like Texas.

Table 5 shows growth in the South and West compared to growth in the Northeast and Midwest over the past 10 years. Looking at the region including Texas, (west south central) growth in personal income has been 5.8% per year. In Minnesota's region, on the other hand, (west north central) growth has been only 3.3% per year. Projecting into the next decade, Chase Econometrics found that growth in personal income in the South and West would still outdistance the rest of the nation.

TABLE 5

GROWTH IN THE SOUTH AND WEST WILL CONTINUE TO OUTPACE OTHER REGIONS

	Manufacturing employment		Real Personal Income	
	1971-80	1981-90	1971-80	1981-90
	Average annual percent Increase			
Northeast & Midwest	-0.1%	0.6%	2.1%	2.4%
New England	1.3	0.7	2.4	2.5
Mid-Atlantic	-0.9	0	1.3	2.2
East North Central	-0.3	0.7	2.4	2.4
West North Central	1.7	2.1	3.3	2.8
South & West	2.4%	2.6%	4.5%	3.2%
South Atlantic	1.4	2.2	3.9	3.2
East South Central	1.3	2.8	3.9	3.8
West South Central	3.7	2.9	5.8	3.1
Mountain	4.8	3.4	5.7	3.8
Pacific	3.3	2.6	4.3	3.0
Total U.S.	1.0%	1.6%	3.3%	2.8%

data: Chase Econometrics, Business Week

Is there a connection between this growth and energy income? We think there is. Taking a look at the return on common equity in energy and non-energy industries (Table 6), it is easy to see that energy industries are much more profitable investments than almost all others, including such high growth sectors as computers. Thus investment dollars are attracted to the energy producing states. With a limited amount of capital available, Minnesota is losing out in the competition for these investment dollars. Yet, despite the evident shift in income and investments towards energy producing states, the Federal Reserve Bank contends that higher energy prices will not have a significant effect on Minnesota's competitiveness in attracting business investment.

TABLE 6

RETURN ON COMMON EQUITY IN ENERGY AND NON-ENERGY INDUSTRIES, 1980*

Energy Industries	
Natural Resources (Fuel)	23.8
Oil Service and Supply	24.2
Utilities	12.9
Non-Energy Industries	
Banks & Bank Holding Companies	17.8
Building Materials	10.9
Electrical, Electronics	19.3
Food Processing	15.6
General Machinery	15.3
Instruments	15.4
Metals and Mining	18.1
Misc. Manufacturing	16.3
Non-Bank Financial	15.9
Office Equipment, Computers	19.2
Paper and Forest Product	12.6
Railroads	13.9
Retailing (Non-Food)	11.5
Special Machinery	7.8
All Industries Composite	15.3

*From "Corporate Scoreboard," Business Week, March 16, 1981, pages 65-100.

The Federal Reserve's analysis of competitiveness is flawed because the question is not whether one plant is located in Minnesota or Louisiana (the two states they use in their example), but whether the whole range of possible investments in Minnesota is comparable to the range available in Lousiana, or any other energy producing state. The energy investments made attractive by high rates of return will stimulate economic growth and investment in other sectors of the economies of the energy-producing states.

Looking at an individual plant location decision, there are other problems that the Federal Reserve Bank ignored. First of all, energy prices increases between 1972 and 1978 created baseline differences in location costs between Minnesota and Louisiana, something that can not be ignored by an individual company. In this case the base rate of return was 7% better in Louisiana than in Minnesota. An investment would have to be larger in Minnesota to achieve the same revenue, and operating costs would be slightly higher as well (Table 7). But the return on this extra investment would be negative since the net revenue (revenue minus costs) is negative, a clear deterrent to location in Minnesota.

TABLE 7

Differences in Investment and Net Renenue for Industrial Plant Located in Minnesota Compared to Lousiana

	Minnesota	Louisiana	Extra Investment, Cost or Revenue in Minnesota
Capital Investment	$34 million	$32.64 million	$1.36 million
Operating Costs	$25 million/year	$24.79 million/year	$ .21 million
Revenue	$35 million/year	$35 million/year	—
Net Revenue	$10 million/year	$10.21 million/year	$-.21 million

Summary

In sum, the Agency finds that the Federal Reserve Bank has initiated a useful approach to the question of income transfer, but has reached the wrong conclusions concerning the regional impact of rising energy prices.

We differ with the Federal Reserve Bank on many individual assumptions. Yet they have found that there is a measurable income transfer from Minnesota to energy producing states and nations. Our estimate is that this income transfer in 1978 was about 60% of our total energy payments. They estimate only 33%.

But with either estimate of income transfer, we found there was a significant dampening effect on the state's economic growth by 1985 - a condition which sets the stage for recession. They did not even attempt to assess the impacts of rising energy prices on the Minnesota economy.

Finally, we found that the transfer of energy payments from Minnesota puts us at a disadvantage vis a vis energy producing states in competing for investment dollars.

In other words, the regional impact of rising energy prices is a large enough problem that it can not be dismissed. Further study is needed to determine ways in which local energy conservation and alternative energy development can help mitigate these effects. In addition, federal and state energy taxing policies should be examined to ensure, at the very least, that they do not exaccerbate the income transfer problems of energy poor states.

The Minnesota Energy Agency believes there are ways to counteract the negative economic effects of energy price increases on the state's economy. But we no longer can afford to ignore the very real problems that are occurring.

Senator **Durenberger**. Our next panel will represent the tax departments of two States: North Dakota and Minnesota. Kent Conrad is the tax commissioner for North Dakota. His predecessor, to whom I referred earlier, is now a U.S. Congressman. We had the pleasure of hearing from Byron Dorgan at our hearings on this subject in July. The State of North Dakota has severance taxes on oil, gas, and their version of coal. Their taxes on coal would be reduced if the bill I have introduced passes in the Congress.

Clyde Allen is the director of the revenue department here in Minnesota. We have invited him to address the question of tax competition from the Minnesota perspective. With Commissioner Allen is Dwight Lahti who will discuss severance taxation in Minnesota as it applies to taconite mined on the Iron Range of Minnesota. We'll go with the order of introduction.

TESTIMONY OF KENT CONRAD, TAX COMMISSIONER, NORTH DAKOTA; CLYDE E. ALLEN, JR., COMMISSIONER, MINNESOTA DEPARTMENT OF REVENUE; AND DWIGHT E. LAHTI, MINERALS TAX ADMINISTRATOR, MINNESOTA DEPARTMENT OF REVENUE

Mr. **Conrad**. I'm very glad to be here to present the alternative view, which I think has unfortunately been underrepresented here today. Perhaps I can make up for some of the statements that I have heard here today which I think seriously misinform you. However, it is understandable, because this is an enormously complicated subject area. I think, if we are to treat this topic seriously and attempt to arrive at a conclusion that is reasonable and just, we're going to have to pay attention to the distinctions which are inherent in the subject.

In July, the Northeast-Midwest Institute issued a study warning that severance taxes threaten to create "a new kind of 'United American Emirates', a group of 'super States with unprecedented power to beggar their neighbors within the Federal system.' "[1] The message—I believe—is very clear that those of us in resource-rich States are somehow "blue-eyed Arabs" intent on gouging our neighbors. I think it is time to examine the basic premise of the argument that consumers are dramatically hurt by the level of our severance taxes. The simple truth is that the effect on the consumer of our severance taxes on oil and coal are directly equivalent to a mosquito bite on an elephant.

First, I'd like to discuss the oil taxes that we have in North Dakota. In November 1980, the voters of North Dakota passed a 6½-percent severance tax on oil to go with the original tax of 5 percent on both oil and gas. We now have an 11½-percent tax on oil, and a 5-percent tax on natural gas. We anticipate that those taxes will generate $448 million over the next 2 years. I think it is important to indicate that that revenue source would not be affected at all by the tax limitation you have proposed.

The important question is: Is the Minnesota consumer adversely affected by the North Dakota severance taxes on oil and gas? The answer to that question is very clearly "No." If North Dakota had no severance tax, oil would sell for the same price in North Dakota that it sells for today with North Dakota having an 11½-percent severance tax. That may seem hard to understand, but it is true. It is true because the price of oil is not determined by adding up the various costs of the product and adding a percentage for profit, in order to arrrive at the selling price. Instead, the price of oil is determined by world market conditions. World market prices determine the price of the commodity in North Dakota. I believe that is very clearly illustrated by the fact that after North Dakota implemented the 6½-percent additional tax on oil, the price of oil went from $39.50 a barrel to $35 a barrel today. With this additional tax, a dramatically higher tax—more than double the previous tax—the price of the commodity still went down. The reason for that is very simple.

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[1] See p. 462.

The oil producer, like the farmer, does not control the price of his commodity. It is determined by world market conditions. A purchaser of oil is not going to be at all interested in what the tax structure is within the State from which he's purchasing oil. He's simply not going to be able or willing to pay more than the world market price for that commodity. The oil producers, like the farmer, can't add on 5 cents to his product when he gets a tax increase. He can't add it on because a world market determines the value of his commodity.

So, the bottom line is that oil in North Dakota is taxed at 11½ percent. When you look at who pays the tax, it is not the consumer. The tax on oil has to be absorbed by the oil industry. In other words, the consumer is paying the highest price already. The question is whether or not the State dips into that revenue stream and takes out its share.

The suggestion by some that a State like North Dakota with large energy reserves can rely on that tax base to keep energy-poor States at a permanent, competitive disadvantage neglects to evaluate the natural competitive advantages of the other States. For example, the State of Minnesota with its 10,000 lakes has enjoyed a competitive advantage over the State of North Dakota for decades. The lakes in Minnesota have attracted thousands of North Dakotans who have paid sales taxes to the State of Minnesota, property taxes to the State of Minnesota, and other taxes levied in your State. At no time did North Dakota suggest that we ought to have a national legislation to limit the levels of Minnesota State taxes because of that competitive advantage.

I might go further to indicate we didn't suggest limiting Minnesota's tax structure, even though—for the history of North Dakota that I'm familiar with, the last 10 years—Minnesota has always had a much higher tax structure than the State of North Dakota. It has had much higher individual income tax rates, on a ratio of about 4 to 1; higher corporate tax rates, three to four times higher than ours; and higher property taxes on commercial property, four to five times higher than North Dakota's. So, even before we had a resource that we could tax, like oil and coal, Minnesota had a much higher tax base than the State of North Dakota.

I want to elaborate on the coal severance tax and its effect on the consumer. We now have a tax on coal of $1 a ton, which translates into approximately 14 to 16 percent of the value of the commodity. That tax will generate $40 million over the next 2 years, which is really peanuts to our State. Nonetheless, the limitation legislation proposed would affect our coal severance tax. Again, I think it's important to ask: What is the effect of the North Dakota severance tax on the consumer? When you ask that question, you need to look at the effect of Montana's severance tax as well, because you wind up paying both.

I have provided for you, in the addendums to my remarks, studies done by the Montana Department of Revenue, and a similar study done by the North Dakota Tax Department which indicate very clearly that the effect on the consumer in Minnesota is less than 2 percent of his/her final electricity bill.[1] The combined severance taxes of Montana and North Dakota are less than 2 percent of the consumer's final electricity bill.

Now, I submit, if you are concerned about the effect of Montana's and North Dakota's severance taxes on the Minnesota consumer, you might do what we have done—remove the sales tax from electricity. That would offset, by a factor of 2½ times the effect of our severance taxes on your State's consumers.

The next point I'd like to make is that Minnesota receives more tax revenue from the product of 1 ton of North Dakota lignite than does North Dakota. That is true because 1 ton of North Dakota lignite produces about 1,100 kwh of electricity. There's about a 10-percent line loss by the time it gets to your State, so you have about 1,000 kwh of marketable product when it comes into Minnesota. That sells in Minnesota, very conservatively, for about $50. You attach a 5-percent sales tax so you get $2.50 from the product of 1 ton of North Dakota lignite while we get $1. So, at the time, you're getting a revenue factor that is 2½ times as great as ours.

We are living with all of the impacts. We live with the air and water pollution; we build and repair the roads; we build the schools; we provide the police and fire protection, and all the rest that goes with producing electricity for the State of Minnesota.

I found it very interesting that Mayor Fraser indicated that the difference between your sales tax on electricity and our severance tax is that your sales tax is a tax voted by Minnesotans to provide for Minnesotans. Well, I think you should remember that the severance taxes that you wind up paying are to pay for something we are producing and sending to you—namely, electricity. The reason many of the plants are being located in North Dakota instead of in Minnesota—aside from it being uneconomical to transport our lignite very far because of costs attached—is because of the total tax picture. That's something that you have to keep in mind—the total tax picture.

I think it's important for you to know that North Dakota has a cutrate property tax on the plants that produce electricity to air-condition Minnesota homes, heat Minnesota schools, and power Minnesota businesses. We have a tax in lieu of all property taxes which generates about $750,000 a year on a 440-megawatt plant. That plant would cost about $550 million to build. If it paid a normal property tax in our State, it would pay about $5 million a year. So in other words, the plants that are producing electricity for Minnesota consumers are paying one-sixth to one-seventh the rate that all other property taxpayers are being asked to pay in the State of North Dakota.

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[1] See p. 363.

The next point to be made is: What are the costs of providing that resource, electricity, to the consumers of Minnesota? What are the costs to North Dakota? We did a study in North Dakota called the regional environmental assessment program, at a cost of $6 million to the State of North Dakota, to assess the economic and environmental impacts of coal development on our State. That study made a comprehensive review——

Senator **Durenberger**. The study was $6 million?

Mr. **Conrad**. Yes. It's a massive study. It included, as just one part of it, an assessment of the total costs and the total revenues coming from coal development. It looked at the income taxes, the sales taxes, local property taxes, and all the revenue sources that come from coal development. It looked at all of the costs associated with coal development. That study determined that by 1983 the State of North Dakota would be $44 million short of meeting the cost of coal development. If you refer back to my last statement on the total tax picture, you can see why it's possible for us to have that kind of shortfall.

In addition, if one looks at siting a plant in North Dakota versus Minnesota, one finds some very interesting differences. If you were to build a 440-megawatt plant in Minnesota and look at what it would pay in property taxes in this State versus what it does pay in North Dakota with the coal severance and the coal conversion taxes combined, one finds that, in North Dakota, it pays a tax of $3.4 million a year; and in Minnesota, it would pay $10 million a year. There is a savings to consumers of $6.6 million a year by siting that plant in North Dakota.

I would suggest that in many ways North Dakota is the real injured party in the relationship of coal development between the two States, and I would suggest that because we were energy self-sufficient in electricity before we started building plants, the plants we have built are largely for producing electricity for export and that export is largely to the consumers of the State of Minnesota. Every time we build a new plant, those new plants have to be amortized, and they are amortized by increasing the rates to all users of that system. When you do that, you dramatically increase the electricity rates to the North Dakota consumer.

I suggest that if you are successful in putting a limitation on our coal severance tax, perhaps we ought to ask our congressional delegation to seek a limitation on the amount of electricity that Minnesotans can import from North Dakota, since that exportation is very adverse to our consumers.

Next, I'd make the point that the proposed 12½ percent limit on State severance taxes simply misses the mark.

Senator **Durenberger**. Kent, are you getting close to the end of your statement?

Mr. **Conrad**. Very close. This point and one more.

The proposed 12½-percent limit misses the mark completely. Let me explain why that's true.

The massive flow of dollars from energy poor to energy rich States, like Texas and Louisiana, are unaffected by the 12½-percent limit. Neither of those States would be affected by the 12½-percent limit. Texas, with its 4.6-percent tax, which, in 1979, generated $1 billion:

and Louisiana, with its tax of 12½ percent, wouldn't be touched by this limitation. In fact, the bill as written is skewed in favor of States with higher valued resources and against States like North Dakota that receive relatively little per Btu of exported energy when considering the coal resources. As I indicated, Texas collected over $1 billion as early as 1979 from its severance tax on oil and gas. It could, in 1979 dollars, go up to the limit of 12½ percent and collect $2.5 billion a year, and be totally unaffected by the limit; while North Dakota would be affected on a revenue source of only $20 million a year.

We're not even covering the cost of development in our State. We have a cutrate property tax which gives us a cutrate tax on energy being exported from our State. I don't believe it is justifiable to suggest that you ought to be limiting our very minor revenue source on coal severance, while having no effective limitation on the massive transfer of dollars to States like Alaska, Louisiana, and Texas. It reminds me of what they call the "Texas Hog Rule": Texas gets in the trough for all it can and then squeals when anybody else gets just a little.

Finally, I wish to point out that at the Midwestern States Association of Tax Administrators, the following resolution was passed:

> We, the members of the Midwestern States Association of Tax Administrators, oppose any intrusion by the U.S. Congress on the States' sovereign right to determine their own tax policy.

I believe that resolution passed because professional tax administrators recognized that it is poor public policy for the U.S. Congress to attempt to restrict the States' rights to establish their own tax policy. It can do nothing but set a bad precedent. Next we will see legislation introduced to limit Minnesota's taconite tax, or Minnesota's property tax, or to limit the city income tax in New York, or interfere in the tax structures of other States. That, I believe, is not something we want to pursue.

The best way to regulate an individual State's policy is to allow the natural tax competition between States to prevent any abuse. We heard Texas Attorney General White indicate that Montana has priced itself out of the Texas market. I think that is the regulatory mechanism that is proper. Let States price themselves out of the market if their severance taxes are too high.

I will conclude by saying that the fact that a resolution of this nature has been passed by the Midwestern States Association of Tax Administrators—which is comprised of professional tax administrators from such important industrial States as Ohio, Indiana, Michigan, Illinois, Wisconsin, and Missouri, in addition to North and South Dakota, Nebraska, Kansas, Oklahoma, Iowa, and even your own State of Minnesota—indicates that it is poor public policy for the U.S. Congress to interfere with the States' sovereign right to determine their own tax policy. I would finally state that it seems to me that those who advocate a competitive system and say they believe in a competitive system, ought to stand by that system when it comes to a question of States' tax policies. I think that is the regulatory mechanism that will work and will prevent any abuse by individual States.

Senator DURENBERGER. Thank you very much. Clyde?

Mr. **Allen**. Mr. Chairman, thank you very much. It's also a pleasure to be here and to have a chance to talk on this subject. I do have a written statement, so I think I will rely primarily on having submitted that in view of your time schedule.

Senator **Durenberger**. All the prepared remarks will be made part of the record.

Mr. **Allen**. Thank you. I'll breeze through it and then comment on several of the other points that have been made here today.

First of all, I am here to support S. 178, which is designed to limit to 12½ percent the tax on the value of coal on federally owned land. That's a significant point. As you well know, Minnesota, along with other States, has often opposed congressional action that tries to intrude, in any way, on the States' desires to set their own internal tax policies. However, I think that one thing you learn very quickly in the field of government is that there are no absolutes. There are occasions when you do have to take some stands on items that are not general policy. It seems to me that there are several good reasons why that case is true today on the subject that we are treating.

First of all, I want to mention that Minnesota does have somewhat of a unique history to bring to bear on this subject. We have been a State that has produced minerals, and therefore has had severance taxes for a good long time. Thus, we can empathize with other States—North Dakota, Wyoming, Montana, or whoever they may be—with regard to their concern that the severance taxes do, indeed, pay the costs of development which might be occurring within those States. So, we do have some empathy. We've had severance taxes in our own State for some 100 years.

I'd like to make the point that Federal action in this situation is appropriate. I think, first of all because coal is a very important national resource. It didn't all come along with the Thirteen Original Colonies that might be able to make some argument about States' rights. Some of it was purchased by Federal purchases, and some of it came in other ways. But it's an important national resource and I think, therefore, a proper subject for congressional scrutiny.

The second major point which I would like to make is that I think there is a clear distinction between cases where States are asking to set their own internal tax policies whereby they tax their people or their businesses and cases where they may be, indeed, exporting the tax. I think the worry here is that some of those taxes may, indeed, be getting exported to the people in other States. It seems to me that that probably is, again, a clear indication that congressional action is warranted, or at least a look at the question of whether Federal action is warranted.

It seems to me that one of the situations we have here is that there is a lack of competition which would ordinarily hold down some of the tax policies that could be set. For example, if you look at the situation, it would appear that some of the Western coal States, indeed, are supported in their marketplace by congressional action. There doesn't seem to be any restriction on the percentage of tax that could be enacted. We have taxes that run to 30 percent. Why not 40 or 50 percent at the mine mouth?

In addition, some of the Federal legislation on air pollution sort of leads to narrowing the marketplace. You can only get coal and other resources that will burn in conformity with the Federal standards from certain places. So, the Federal Government has acted, in some ways, to give a competitive advantage to some of the coal producing States who happen to have the particular kind of coal that will meet those standards. So it would seem, again, that if Federal action has helped the marketplace, Federal action may, indeed, be justified in terms of the tax that is charged.

Minnesota's tax policies, with regard to severance taxes, find themselves in a little different situation. I don't think we have had taxes that run as high as we see today in some of the energy areas. Indeed, on our severance rate on taconite for the year 1980, we ran about 4.9 percent. That figure can be argued a little bit up or down because it's a complicated formula that involves some 3-year averaging, on occasions. Basically, our tax rate on taconite ran 4.9 percent. That's a long way from some of the rates charged on energy.

All of this, again as I said, is in my statement. I'm going through it quickly so I can get to some of the other points.

I want to come back again to the point I made earlier. It seems to me the key point here is this: I have seen many defenses for the taxes that are charged. Those defenses all seem to be couched in terms of what cost that the tax levied at the mine mouth, for example, makes up as a percent of the ultimate kilowatt-hour, or what have you. It doesn't seem to me that that's an appropriate measure. It overlooks a very basic economic factor—that there is value added all along the way in any industrial process. We ought to look at tax rates to see whether they are appropriate on the particular component, as that component is valued, not as the finished product is valued. I don't think arguments which simply say that the cost of the severance taxes represent only 2 percent of the finished product—or 1 percent, or whatever it may be—is appropriate. That may be interesting in terms of analyzing the total cost for a particular product, but it is not an appropriate measure for judging the validity of the tax itself. I think that's a key point.

Let me go on to cover just some of the remarks that were made earlier today and comment on them. I think Mayor Fraser made a significant point when he indicated that General Revenue Sharing formulas have often included local tax efforts. Severance taxes are included as part of that local tax effort and, therefore, are a double-edged sword for some of the nonproducing States. Those States are paying some of those taxes. Those taxes are then benefiting the producing States in terms of the General Revenue Sharing formula. I don't think that's quite correct.

While we're on that same point, it seems to me that in many of the Federal expenditure programs there are minimum formulas built in that say particular States, regardless of the other factors which might be considered in that formula, get a certain minimum. It seems to me that if some of those States, which in many cases may be the low population States, are willing to benefit from some kind of Federal action, they ought to also be willing to look at Federal action. [Laughter.]

Just in case you're worried about the competition here, we've been working all morning on some cooperative measures back and forth. So, we aren't altogether at odds.

At any rate, back to some of the other points. Just so you know how important some of the State tax policies and the State tax competition can be for two States, I'd like to go through a couple of points. We've had a lot of economic discussion today and it's couched in large dollar figures or kind of complicated economics. Let me try to bring that back to some examples.

There is tax competition among the States that border one another. North Dakota has a 5-year break on property taxes for new and expanded industry. I can quote from a report by Kent's predecessor that said that that break had been installed in order to try to attract new industry from around the country—and I'm paraphrasing. It said that it had largely been unsuccessful in attracting industry from around the country, but it had been very successful in attracting industry from Minnesota. So, there is competition among neighboring States. If we provide the fiscal wherewithal through severance taxes for States to create that kind of advantage, that phenomenon will occur. Indeed, we are suffering badly in Minnesota in Breckenridge, Moorhead, and the East Grand Forks. I was up there earlier last week and that situation is a very serious matter.

A couple of other points. The 6½-percent wellhead tax that Kent mentioned, I believe, has been used this year to help provide some tremendous funding for local units, particularly school districts. As a result, a city like Fargo was just recently able to conclude an 18-percent increase in teachers' salaries. At the same time, the report mentioned that property taxes would probably still be held the same or perhaps dropped some. That's a 6½-percent wellhead tax that comes back to compete directly with Moorhead across the border from Fargo.

I would also like to respond—and this will be my final point—to the Federal Reserve report which indicated—if I understood it right—that much of the income generated came back to Minnesota. I suspect that is true if you look only at the private sector. However, if you look at the public sector and the competition that I've just talked about, I think you will find that there is a very large chunk of money building up in some of the other States with which they will compete for Minnesota business and industry. That, in turn, is eventually bound to have an impact entirely opposite to what the Federal Reserve concluded. It will, indeed, take personal income out of Minnesota. I see the situation getting worse at the moment because of our disparity in terms of energy resources.

I will conclude at that point and try to stick to my limit here. Thank you very much.

Senator DURENBERGER. Thank you. Dwight Lahti?

Mr. LAHTI. Thank you, Mr. Chairman. Senator, you asked me to clarify the mineral taxes in Minnesota—what they are, and how they work—in a period of 10 minutes. It will be very difficult to do that. In my written statement to the subcommittee, some 15 pages, I tried to summarize as best as I could some of the technical aspects of our law. My comments now will try to highlight some of the key characteristics of that earlier written statement.

The current minerals tax structure of Minnesota provides for 14 taxes that apply either directly or indirectly to mining and/or minerals. In order to help understand the relationship of our taxes to those of other States, I have classified them into three commonly known groups: excise, property, and income. Our excise group includes taxes on severance—our occupation tax—on sales and use, and on the payment of royalties for the privilege to either mine or explore. In the handout covering my oral statement you'll see that I have set up the three groups.

I'll have to caution you a bit. There are characteristics of our occupation tax that could be argued should fall into the income tax group. And, as you continue to review the listing, I've shown our production tax to be in our property tax group; yet there are characteristics of it that are also based on forms of severance or production which might cause one to argue that it belongs back in the severance group. I tried to put some skeletal form around this as best I could. So be it; these are the classifications.

Our taxes might also be grouped according to how they are distributed, that is, either to the State general fund or to local taxing districts. If you look at Minnesota's tax structure from that viewpoint, the tax that generates the most significant dollars is the taconite production tax. In production year 1980 it generated $87.2 million, and most of that tax is redistributed to cities, towns, and other local taxing districts.

With the exception of the production taxes, the remaining property tax group is administered by the county. We only involve ourselves in estimating the amount and value of the reserve. Of the remaining property tax group, the most significant in dollars would be the ad valorem tax on natural ore. In production year 1980 this provided approximately $4 million worth of property tax for local taxing districts.

Now having looked at production taxes and the ad valorem tax on natural ore, let's look at the remaining taxes—which would include occupation, sales, royalty, and the gross earnings taxes. These tax moneys are dedicated to the State general fund. In production year 1980 that grouping generated $30.2 million worth of taxes.

With that for an introduction let me move on to some other points. You already heard Commissioner Allen speak about the value of the tax and its relationship to the value of the taconite, so I'll glide past that. Obviously I'd agree with the commissioner on that point in terms of the figure that he quoted.

Maybe now would be a good time to turn our thoughts to copper-nickel. Again from your letter, Senator, I can see the subcommittee's interest in comparing various States' tax structures and policies. In the past 18 months we have done much work in trying to compare our existing taconite tax to our existing copper-nickel tax law. The purpose was to determine what the comparative, overall tax burden was on these two minerals.

Logically it may sound valid to compare the copper-nickel tax to the taconite tax, especially when the most likely reference point that a Minnesotan would easily understand is taconite. Yet, even in a two minerals' tax comparison, in the same State, this becomes an exercise of comparing apples to oranges. That's not to say that the comparison can't be made, but great care had to be taken in converting the elements to a common base.

Next, I thought it might be of interest to share with the subcommittee some of the problems that we had in making our comparison.

One of the common misunderstandings about copper smelting and refining is to parallel that to the taconite beneficiation taking place in Minnesota. Those two processes are entirely different. The taconite beneficiation only adds value to an enhanced form of what still could be considered a natural, raw resource—or concentrate. Whereas, the smelting and refining process for copper and nickel brings a copper and/or nickel concentrate to a finished metal and readies it into marketable form, in the sense of a buy and sell market. Making this distinction is important for many reasons. For example, the importance of recognizing the difference in production costs is necessary if a tax were to be based on net taxable value, meaning crude ore less processing costs.

Another problem that we experienced is the difference in how taconite pellets versus copper and nickel are quoted for market. Let's review for a minute. Simply stated, the occupation tax is based on the value of crude ore produced at the edge of a mine in Minnesota. A market price for concentrates would then be a logical place to begin that valuing process.

For taconite pellets there is a theoretical market value quoted as the "Lake Erie Value," which translated means the value of pellets resting—and unfortunately, they are not resting in Minnesota—on a dock at a Lake Erie port. Although it is administratively difficult to modify this value in order to express it in terms of the value of ore at a Minnesota mine, it can still be done more easily than it could be for copper.

Let me explain further. For copper and nickel there is no quoted price for concentrates. Instead prices are quoted in terms of finished metal. Consequently, if smelting were to take place outside of Minnesota, it would be extremely difficult to isolate the processing costs of the finished metal relative to the value of production from Minnesota concentrates. Yet, in order to express copper-nickel ores in terms of value at a Minnesota mine, this procedure would be necessary.

It might be a good point to make here that we don't necessarily have to keep referring just to copper-nickel. Parts of this exercise are going to apply in many situations as we go through a valuing or a comparison process. I chose copper-nickel because it has meaning to us in Minnesota.

The last problem—which may seem rather minor—unless it is taken into consideration, it could cause differences in comparison. It is something as simple as weight. Copper concentrates are measured in conventional tons—in other words, 2,000 pounds per ton. Taconite pellets are measured in long tons, or 2,240 pounds per ton. One must be careful in comparing such concentrates to modify them to the same weight base, especially when the impact of tax might be measured by ton.

In conclusion, I'd like to highlight a few pieces of legislation that Minnesota has passed in order to stimulate continued mineral development. The first piece of legislation deals with special provisions that were granted to the taconite industry to exempt them from sales tax for construction materials used in expanding Minnesota's Iron Range taconite pellet capacity. This expansion exempted approximaely $1 billion of construction materials from sales tax. That exemption ran from January 1, 1974, to July 1, 1978.

The next piece of legislation I'd like to discuss was passed in 1963. It has come to be known as our "Taconite Amendment" which, through legislation, provides for a 25-year period during which a taconite producer would pay an amount of combined occupation royalty and excise tax no greater than what a manufacturing corporation might pay under the income and excise laws, or what the producers would have otherwise paid under the 1963 occupation royalty excise tax law. I might add, portions of this legislation are presently being litigated in the courts.

My last example of special legislation to encourage mining deals with another sales tax exemption. The taconite industry is exempt from paying sales tax on the mill liners and rod and balls consumed in production. These are high cost items and are consumed rapidly.

Finally, our tax laws do allow credits for things like the utilization of labor, research, and smelting and refining if such costs are incurred in Minnesota. Just as an example, the effect of a labor credit in Minnesota in our occupation tax report takes a statutory rate of 15 percent and reduces it down to an effective rate of 6.75 percent.

With that I'll conclude my remarks.

Senator **Durenberger**. Thank you very much. Let me compliment you, Dwight, on the quality of your written statement which will be made part of the record.

Mr. **Lahti**. Thank you, Senator.

Senator **Durenberger**. I've got a couple of general questions.

First, while we're on the subject of the taconite tax and so forth, Rod Loper wrote a letter to the editor of the St. Paul paper a week or two ago. He suggested that Minnesota businesses, consumers, and everybody else would be better off if we raised the tax on taconite. In other words, get that big business and tax them. As a practical matter I understand that's relatively impossible. Maybe just for the record, Commissioner, you might clarify that issue for us.

Mr. **Allen**. Senator, I think the idea of raising the taxes on taconite to significantly help with the revenue picture is impractical for two reasons. First of all, with our taconite—both in production and occupation—I believe it makes up a little over 3 percent of our total State revenue for the general fund. So for it to have any significant impact on that, you'd have to raise the tax quite a bit. Given the world competition at the moment, in terms of supply, that's not practical at all.

Senator **Durenberger**. Which is another one of the problems of the three Governors who are talking about taxing grain. They have that problem in grain and they're never going to get it passed.

I suppose you can go around the horn on a number of those things and find certain of these severance tax threats that are impossible to deliver. Of course, you have to recognize the phenomenon that exists at the present time which enables the North Dakotas, the Montanas, the Louisianas, and the Texases, to benefit from a non-marketplace. You also realistically have to recognize the fact that it isn't going to last forever. There will be a time when it's over with.

Frankly, that is one of the weaknesses in this idea—that you can put an agreed upon, flat percentage limitation on severance taxes. I never hesitate to admit the weaknesses in my argument. I think that's one of the things that we have to try to deal with here when we put this, not in the context of States' rights to tax resources, but on the implications for all States in this country of fiscal disparities which result when taxes can be substantially raised and exported.

They can be raised, Kent, because there are no political consequences to raising them. There is a limit to how much Minnesotans will tax themselves and a limit to how much North Dakotans will tax themselves. However, there is a substantially lesser political limitation on the amount of tax that a Minnesotan will put on a product which can be exported. That is true for North Dakota as well—again, in the absence of a marketplace and where there is no genuine competition to put that particular Minnesota product out of business, or North Dakota product out of business.

Mr. CONRAD. Well, two things. I don't agree with your assessment that there is not a marketplace. There is a marketplace. There is very clearly a marketplace because all of the resources are in competition. Oil is in competition with natural gas; natural gas is in competition with coal; North Dakota lignite is in competition with Montana subbituminous coal.

If you think that it is easy to pass a severance tax in North Dakota of the level that we have, then you missed the three legislative sessions in which I was involved in the fight to try to get what I consider to be a reasonable severance tax for North Dakota. The last session we had in 1979 went all night. It was an incredible battle. In fact, if you had taken a poll in North Dakota, you would have found the people were evenly divided on the question of increasing the severance tax—45 percent opposed, 45 percent in favor, 10 percent undecided—when we passed the last increase of the severance tax.

Senator DURENBERGER. Isn't that an issue of benefits?

Mr. CONRAD. No. It was a question of level because of two arguments. No. 1, North Dakota consumes electricity and North Dakota consumers pay just as Minnesota consumers pay. No. 2, the competition issue was very effective—that is, there is competition and people are very interested in having a number of plants sited in North Dakota because of the jobs that those plants provide. So I think it is very easy to overestimate the attractiveness of the argument that we raise the severance tax.

I've got a question for you which I think is terribly important to answer in the process that you are going through. That is, I tried to make the point that the 12½-percent limit misses the mark. It seems to me that what I really hear is not so much concern about the effect on the consumer, because the consumer just isn't very much affected. Our oil tax, which is the big revenue producer, has no effect at all on the consumer. The coal severance tax has a very minimal effect. So the real concern is the fiscal disparities. That's what I sift out of all of this as the nugget of the issue for you. That problem is not answered, that I can see—and maybe you can show me differently—by the 12½-percent limit. Because, as I've indicated, our oil tax, which will generate $448 million over the next 2 years, is not affected in any way. Our coal severance tax, which will generate $40 million, or one-eleventh of the oil tax, is affected. Can you explain to me how it helps to pass a 12½-percent limitation?

Senator **Durenberger**. How's it going to help the fiscal disparities? You're dealing here, in the case of energy minerals, principally with depletable resources. You're dealing in the situation with regard to Montana—and I can't recall the North Dakota situation—with levying a tax to cover the expense of government and the heritage fund concept as well. This ties again into the depletable resource question.

Frankly, just arriving at a percentage that you ought to come up with is a difficult proposition. Admitting that a severance tax is going to solve the problem of fiscal disparities is not anything I ever put forward as an argument. That's why we've had the issue of severance taxes, and a whole variety of other issues—all these allocation formulas we talked about earlier in the day—put not in the context of a hearing on S. 178, but a hearing on the issue of fiscal disparities. We are trying to sort out the Federal role, the State role and, hopefully, a multi-State kind of role in terms of the kinds of meetings that the Lieutenant Governor proposed they were going to have, and so forth. We are just trying to raise this above the level of Minnesota politicians with only consumers' interests at heart. We are trying to raise it to the level of what happens when we, at the national level, start devolving responsibility back on the States; what happens to the ability of certain States; and how do they react to that.

Certain models are being built for them in the energy/mineral severance tax that are adaptable to other things. I don't know all the Supreme Court cases—you guys are familiar with them—where a variety of businesses, particularly oil companies, are being taxes on their operations in various States. We're going to start a lineup on the docket of the U.S. Supreme Court of States that are hungry to tax whatever kind of business they can get at in their State.

I think it's really important—and you probably understand it as well as anybody—to understand the reaction in Minnesota to what's going on in North Dakota. It isn't a question of intent or anything else. It's my impression—and I could ask you a whole series of questions to bring this out—but it's my impression that a good deal of North Dakota's wheat gets to foreign markets by going across Minnesota to Duluth, and much of it travels by truck. I know, for a fact, that grain trucks are filling up with fuel on the North Dakota border before they get to Minnesota because there is a difference in the fuel tax. There are some people who do care about States' tax structures. It must be truckers who do; they recognize that difference.

I do know, for a fact, that a part of your severance taxes are used to subsidize highway construction in your State. In our State we can't do that. We're limited strictly to the gas tax. I do know that there are a lot of Minnesotans up there who would like to build a toll road on Highway 2 or some other road. But that isn't going to help the seaway port of Duluth and it isn't going to help a lot of other people. I tell you this to reflect the kinds of feelings and reactions that develop when people can see clearly some of the inequities that exist in the tax structure.

Mr. **Conrad**. I just hope to clearly make the point that the oil taxes will raise about $448 million over the next 2 years. The coal severance tax will raise $40 million over the next 2 years of that $488 million. The limitation would only affect the coal severance tax and mean a reduction in collections of about $8 million of that $488 million from severance taxes over the next 2 years. So if the concern is the fiscal disparities, my point is that this vehicle is not going to get you where you want to go. It just misses the mark on the fiscal disparity issue, if that's the issue you're concerned about primarily.

Senator **Durenberger**. I guess the thing that's bothering me—and I tried to get at this briefly with the attorney general from Texas when we talked about decontrolling natural gas—is the fact of competition and the depletable nature of the resource. There will come a time when production goes down. It seems to me relatively unlikely, unless that timeframe is stretched out over a rather long period of time, that you'll be able to maintain that $400 million a year level, at whatever percent the severance tax may be. As either the product itself declines or the demand for it declines, you're going to have to find something else to meet that level, or, you can just keep increasing the percentage of your severance tax so it always raises at least $400 million. One of the values, I suppose, of putting a 12½-percent—or a 10-percent, or a 20-percent, or whatever it is—limitation on severance taxes now, while both demand and production are high, is that you know that time is coming. You can work your way up to it as gradual as possible knowing that there is a limit beyond which you can't go. I guess that's the best argument I can make for enacting a severance tax limitation now.

Let me ask you a couple other questions concerning the taxation of electric generation. I asked Congressman Dorgan, when he testified before the subcommittee, to provide us with as much information as possible on that situation. I know about it because I happened to work, once upon a time, for the electric cooperative industry. I don't think a lot of Minnesotans realize the potential for added taxation that exists. I think it would be helpful to all of us involved in this process—if it isn't spelled out in your written testimony in some way—that you do take the time to spell out what you summarized in that regard for the subcommittee. Because this is not just a Minnesota-North Dakota issue; it's an issue that's going to be facing us in the future.

We export—or Wisconsin imports an awful lot of our power also. Wisconsin independently makes decisions about nuclear generated electricity which impacts on Minnesota utility consumers in an adverse way. I think we can all learn something from one of the first major exporters of electric power—which North Dakota has been—because of the predictability of lignite costs and the unpredictability of Burlington Northern and other costs.

Another question that I have is not directly related to the severance tax. We have problems in Minnesota—in Moorhead and Staples and a variety of other places—with meeting the costs of transporting coal to our markets. Certain markets—and I'm presuming that you're getting a very small piece of the coal action—are in Wyoming and Montana. A certain amount of it goes across South Dakota on the Milwaukee Road, and through North Dakota on the Burlington. I'm wondering if you have, in North Dakota, any situations where those unit trains are creating substantial problems for communities. Have you found a way to address those costs out of something other than the motor fuel tax?

Mr. CONRAD. We have a very serious problem developing—a problem that is going to become acute as we get into the early 1980's. Because of the volume of traffic moving through North Dakota, the vast majority of which is Montana coal, 40 million tons move through North Dakota in 1 year. Of that about 2 million tons is North Dakota coal in shipment. So the vast majority is Montana coal moving through our State on unit trains. Of course, those trains go right through the heart of many communities. As a result, we're having substantial disruptions in those communities between the northern part of the town and the southern part of the town.

Again, we have looked for potential revenue sources since we're not meeting the costs of coal development now with our two taxes—the severance tax and the tax in lieu of property tax. It is very hard for us to find some way to pay for what's going to have to be done in these cities, especially the major cities of Bismarck, Fargo, Dickinson, Jamestown, and Valley City. These cities are going to have to have substantial work done to provide crossings, and where that money will come from is not known to me.

Senator DURENBERGER. I wish there was a way while you two guys are cooperating—and maybe this is getting off the track a little bit—but I don't know two States that have more at stake in trying to find an answer to that problem.

Again it starts our thinking on the basis that that 75 percent of coal we're talking about is coming off of Federal lands in Montana and Wyoming--I think I'm accurate on that percentage. We've got plenty of testimony on that. Keep in mind that 90 percent of the royalties, due the people of this country for that coal, stays in Montana and in Wyoming to do a variety of things—including reclamation. I don't know why, in the world, either that royalty process or some other process can't be stretched to include the North Dakotans and Minnesotans. We are as much impacted by the extra transportation as anyone. Whether it's going after the royalties or after a tax on the transportation in some way. If we need help from the interstate commerce clause, meaning some legislation from the Federal level, in order to do it, I think we have to find a way to solve that problem.

Mr. CONRAD. You know the Burlington Northern is going out of the railroad business. They're going to form a holding company and split the mineral resources from their rail operations, pretty much going out of the branch line railroad business altogether in our State. So maybe it will be a chance for somebody else to go into that business. Maybe Clyde Allen, director of the Minnesota Department of Revenue, can be the rail commissioner. [Laughter.]

Senator DURENBERGER. Does anybody have anything to add? We've run somewhat past our time.

I wish to conclude this hearing by expressing my appreciation to all three of you and to the commissioners for the difficulty of their jobs. I'm sure both of you are going to contribute many things in order to put this in the context of fiscal disparities, so we can get it out of the context of one State attacking the other or taking advantage of the temporary largess of another State. I think that's where it belongs.

We just happen to be two neighbors who are seeing the consequences of this better than other States in this country. The consequences are there for other States. If there is a better way to solve this problem than just looking at the severance tax limitations, this subcommittee is certainly the place to make those suggestions. I thank you all very much for your testimony.

[The prepared statements of Mr. Conrad, with attachments, Mr. Allen, and Mr. Lahti follow. Mr. Lahti's "Summary of Minnesota Mineral Taxes and How They Work" and "Summary of Issues Regarding Copper-Nickel Tax Policy" can be found on pp. 592 and 609, respectively.]

TESTIMONY OF
NORTH DAKOTA TAX COMMISSIONER KENT CONRAD
BEFORE THE
SENATE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS
ON FISCAL DISPARITIES, STATE ENERGY TAXATION AND TAX COMPETITION

August 31, 1981

In July, the Northeast-Midwest Institute issued a study warning that severance taxes threaten to create "a new kind of 'United American Emirates,' a group of 'super states with unprecedented power to beggar their neighbors within the federal system.'" The message is clear that those of us in resource-rich states are "blue-eyed Arabs" intent on gouging our neighbors. It is time to examine the basic premise of the argument that consumers are hurt by the level of our severance taxes.

The simple truth is that the effect on the consumer of our severance taxes on oil and coal are directly equivalent to a mosquito bite on an elephant.

OIL TAXES – THE NORTH DAKOTA EXPERIENCE

In November of 1980, the voters of North Dakota passed an oil extraction tax of 6½% to apply to the value of oil at the wellhead. That tax is in addition to our 5% tax on the value of oil and gas at the wellhead, which is in lieu of all property taxes. Therefore, our total tax on oil in North Dakota is 11½%, and our total tax on natural gas is 5%. We anticipate total collections for all units of government of $448 million from these taxes over the next two years.

Is the Minnesota consumer of oil produced in North Dakota adversely affected by the new 6½% oil extraction tax in North Dakota? The evidence clearly demonstrates the answer to that question is, "No." In order for consumers to be adversely affected by the additional tax imposed by North Dakota on oil, the price of crude oil would have to have increased as a result of the additional tax. Precisely the opposite happened. That is, the price of crude oil before imposition of the 6½% tax was $39.50 per barrel, and the current price after the 6½% oil tax has been fully implemented is approximately $35 per barrel. In other words, the price of the commodity has declined even in the face of a tax increase.

The North Dakota experience demonstrates quite clearly that a tax on oil at the wellhead is not a pass-through tax because the price for oil is determined by world market conditions and not by the oil producer. Purchasers of oil are not willing to pay more than the world market rate in order to compensate producers for an increased tax levied by the state where production occurs. As a result, an increase in the level of state taxation must be absorbed out of the profits of the oil industry and is not extracted from the consumer of the oil produced in our state.

The oil producer, like the wheat farmer, simply cannot add increased taxes onto the price of his product because neither the oil producer nor the farmer controls the price of his product. World market conditions control the prices of both commodities and are unaffected by levels of state taxation. Since the oil tax levied by North Dakota is clearly not passed on to consumers, I can think of no valid argument for limiting the level of our current oil production and extraction taxes.

The suggestion by some that a state like North Dakota with large energy reserves can rely on that tax base to keep energy-poor states at a permanent, competitive disadvantage neglects to evaluate the natural competitive advantages of the energy-poor states. For example, the state of Minnesota with its ten thousand lakes has enjoyed a competitive advantage over the state of North Dakota for decades. The lakes have attracted thousands of North Dakotans who have paid sales taxes, property taxes and income taxes to the state of Minnesota, but at no time did North Dakota suggest that we ought to have national legislation passed to limit the levels of Minnesota state taxes because of that competitive advantage.

COAL SEVERANCE TAX – THE EFFECT ON THE CONSUMER

North Dakota levies a coal severance tax of $1 a ton, which we estimate will generate $40 million for the state of North Dakota over the current biennium of July 1, 1981, through June 30, 1983. I am providing you with a study done by the North Dakota Tax Department on the effect of that severance tax on the consumers of electricity provided by Minnesota Power & Light, Minnkota Power, Montana-Dakota Utilities, Northern States Power, Northwestern Public Service, Otter Tail Power, and the United Power Association. I am also providing you with a similar study conducted by the state of Montana on the cost to the consumer of the Montana severance tax in 1980.

It is interesting to note that the effect of North Dakota's severance tax on the Minnesota Power & Light customer is one-half of 1% of the total residential electricity bill. The effect of Montana's severance tax is 1.2%, for a combined effect of coal severance taxes on the Minnesota Power & Light consumer of 1.7% of the total residential electricity bill.

Similarly, a customer of Northern States Power pays virtually nothing as a result of North Dakota's severance tax and approximately 1.1% of their average annual residential electricity bill as a result of Montana's coal severance tax. A customer of United Power Association pays 1.8% of their total residential electricity bill as a result of North Dakota's coal severance tax. A customer of Minnkota Power Cooperative pays approximately 1.4% of their average annual residential electricity bill as a result of North Dakota's coal severance tax (A1, A2). The point is very clear that less than 2% of a Minnesota consumer's electricity bill is due to coal severance taxes in Montana and North Dakota.

MINNESOTA RECEIVES MORE TAX REVENUE FROM THE PRODUCT OF ONE TON OF NORTH DAKOTA LIGNITE THAN DOES NORTH DAKOTA

The state of Minnesota actually receives more revenue from the product of one ton of North Dakota lignite than does the state of North Dakota. That is true because one ton of North Dakota lignite produces approximately 1,000 kwh of electricity which markets in the state of Minnesota for $50. Minnesota attaches a 5% sales tax to that amount and receives $2.50 in sales tax revenue on the electricity produced in North Dakota. North Dakota receives $1.00 in coal severance tax on the one ton of lignite coal used to produce that electricity. So Minnesota is receiving 2½ times what North Dakota is receiving on the product of one ton of North Dakota lignite.

North Dakota, however, is having to pay for all of the impacts associated with the production of that electricity. North Dakota is paying for the new roads, the new schools, and the increased fire and police protection associated with that coal development. North Dakota is paying for the costs of siting, reclamation enforcement and regulatory procedures associated with that coal development. North Dakota is contending with the increased air and water pollution and the threat of a long-term loss of agricultural productivity as a result of that coal development. If Minnesota were truly concerned about the impact of our severance taxes on its consumers, the state of Minnesota could do what we have done in North Dakota and remove the sales tax from electricity. That one action would offset the entire effect of our severance tax on the Minnesota consumer by a factor of 2½ times.

THE TOTAL TAX PICTURE IMPORTANT

It is easy to focus on the severance taxes of the states which provide the coal and the electricity necessary for consuming states, but an investigation of the entire tax structure of the producing states on the coal industry would be necessary to make a fair judgment as to whether or not producing states are being unfairly compensated.

For example, you should be aware that North Dakota has a cut-rate property tax on the plants that produce electricity for the consumers of Minnesota. In North Dakota we have a tax, in lieu of all property tax, which is known as the conversion privilege tax, which is levied at the rate of .25 mill per kwh. That tax generates tax revenue of approximately $750,000 a year on a 440 megawatt plant, which costs roughly $550 million to build. If that amount of property were taxed as all other commercial property is taxed in North Dakota, it would pay a property tax of approximately $5 million a year.

In other words, the plants used to generate electricity to air condition Minnesota homes, heat Minnesota schools and power Minnesota industry pay a tax in lieu of property tax, which is one-sixth to one-seventh the rate all other North Dakota property tax payers are expected to pay. If you seek to limit our coal severance tax, it would be a very easy matter to more than make up for the revenue loss by increasing our taxes on the plants.

THE COSTS OF COAL DEVELOPMENT IN NORTH DAKOTA

North Dakota sponsored a Regional Environmental Assessment Program at a cost of over $6 million to determine the environmental and economic impacts of coal development on our state. One of the products of that study was a comprehensive review of the costs and revenues associated with coal development in the period from 1976 to 1983, considering all projects approved for development.

That study looked at all costs to state and local governments resulting from coal development and all state and local revenues associated with that same development. A conclusion of that study was that the combined deficits to state and local government from coal development for the period from 1976 to 1983 would be $44 million (A3, A4).

That conclusion did not include any costs for the negative impacts of air and water pollution, potential long-term loss to the agricultural productivity of land, aquifer damage, or any other environmental costs. It also did not include costs for projects completed prior to 1975. I might add that the study was controlled by a legislative leadership strongly opposed to a higher coal severance tax, and therefore, the costs developed in the study are quite conservative.

COSTS OF A 440 MEGAWATT PLANT IN MINNESOTA COMPARED TO WHAT IT PAYS IN NORTH DAKOTA

To judge the fairness of our tax structure on coal development in North Dakota, it is interesting to review what a 440 megawatt plant pays in North Dakota compared to what it would pay if it were sited in the state of Minnesota. I make the comparison between property taxes in Minnesota and coal conversion and coal severance taxes in North Dakota. Clearly, this comparison greatly understates the differential between the two states because we omit Minnesota's much higher levels of corporate and individual income tax and state sales tax.

	440 MW plant cost	=	$550,000,000
	Minnesota Property Tax (63% exempt; 5% on remainder)	=	$ 10,200,000
Less:	N.D. Conversion Tax (based on actual receipts)	=	$ 750,000
Less:	N.D. Severance Tax (2.7 M̄ tons @ $1.00)	=	$ 2,700,000
	Savings to Consumer by Locating Plant in North Dakota vs. Minnesota	=	$ 6,750,000 per year

As the table shows, there is a savings just on property taxes to consumers of $6,750,000 a year by locating a 440 megawatt plant in North Dakota instead of Minnesota. Perhaps we should have our Congressional delegation introduce legislation to limit the amount of Minnesota's property tax.

NORTH DAKOTA IS THE REAL INJURED PARTY

While Minnesota's public officials complain of the severance taxes in North Dakota, our state bears the brunt of the factor which is actually responsible for the geometric increases in the cost of electricity –increased demand. The capital costs of new generating capacity is what is really driving up the cost of electricity to consumers. North Dakota suffers from Minnesota's hunger for electricity. Minnesota utilities are siting their plants in North Dakota, stringing their high voltage power lines across our state. And what do we get? We get the higher electricity prices that result when those new plants open.

In other words, North Dakota consumers are hurt by the demands for new electricity supplies made by consumers in Minnesota. We were energy self-sufficient before the new plants were constructed. Those plants are being constructed largely for the benefit of consumers in Minnesota. But every time a new plant goes on line, the costs of that plant must be paid for by all the consumers of electricity in that system. That means North Dakota consumers are being asked to pay millions of dollars in increased electricity bills every year to pay for plants constructed to meet the electricity demands of Minnesota consumers.

If you are successful in passing a limitation on our state coal severance tax, then perhaps we should ask our Congressional delegation to introduce legislation limiting the amount of electricity Minnesota consumers can use because of its adverse impact on North Dakota consumers.

THE PROPOSED 12½% LIMIT ON STATE SEVERANCE TAXES MISSES THE MARK

The proposed limit will do little to stop the massive flow of dollars from the energy-poor to the energy-rich states like Texas and Louisiana since their severance taxes on oil and gas would not be affected by the 12½% limit. As the bill is written, the limit is skewed in favor of states with higher valued resources and skewed against states like North Dakota that receive relatively little per BTU of exported energy.

Texas collected over $1 billion as early as 1979 from its severance taxes on oil and gas. It would receive 2½ times that if it increases its taxes to the limit proposed in this legislation. The weakness of the proposed limitation would then be clear. Texas could collect $2,500,000,000 a year in severance taxes and not be affected by the limitation, while North Dakota would be affected by the limitation on a revenue source generating $20,000,000 a year.

THE MSATA (MIDWESTERN STATES ASSOCIATION OF TAX ADMINISTRATORS) RESOLUTION

I am providing you with a copy of a resolution I introduced at the Midwestern States Association of Tax Administrators on August 14, 1981. The resolution concludes, "We, the members of the Midwestern States Association of Tax Administrators, oppose any intrusion by the United States Congress on the states' soverign right to determine their own tax policy." (A5)

The resolution was passed with the clear understanding that it related to the move in Congress to limit state severance taxes, and it also relates to the Mathias-Conable legislation to limit the states' right to tax multinational corporations in certain ways.

I believe the resolution passed because professional tax administrators recognize it is simply poor public policy for the United States Congress to attempt to restrict the states' soverign right to establish their own tax policy. It can do nothing but set a bad precedent. Next we will see legislation introduced to limit Minnesota's taconite tax, or Minnesota's property tax, or legislation to limit the city income tax in New York City, or interfere in the tax structures of other states. That, I believe, is not something we want to pursue. The best way to regulate an individual state's tax policy is to allow the natural tax competition between states to prevent any abuse. Any state that establishes a severance tax which is out of line with the marketplace will soon find its production of oil, coal or natural gas without a market. That is the mechanism we should use to regulate the fiscal disparities you are concerned about here today.

I note that the Midwestern States Association of Tax Administrators is comprised of professional tax administrators from such important industrial states as Ohio, Indiana, Michigan, Illinois, Wisconsin and Missouri, in addition to North and South Dakota, Nebraska, Kansas, Oklahoma, Iowa, and even your own state of Minnesota. The fact that states as diverse as those which make up the Midwestern States Association of Tax Administrators have passed such a resolution indicates very clearly that it is simply poor public policy for the U.S. Congress to interfere with the states' sovereign right to determine their own tax policy.

(A1)

SUMMARY OF THE COST TO THE CONSUMER OF THE NORTH DAKOTA SEVERANCE TAX
1980

Utility	Quantity	Severance Tax per ton	Severance Tax paid	Residential % of Total Kwh Sales	Avg # of Residential[12] Customers	Cost per Residential Customer	Average Annual Residential Bill	Severance tax as a percentage of total bill.
Minnesota Power & Light[1]	2,246,188[2]	.89	$1,999,107	8.35	96,265	$1.73	$368.56	.5
Minnkota[3]	1,454,708	.89	1,294,690	32.99	59,180	7.22	509.43	1.4
Montana Dakota Utilities[4]	1,085,000[5]	.89	965,650	42.81	89,790	4.60	315.62	1.5
Northern States Power[6]	21,032[7]	.89	18,718	27.80	958,036	----	332.18	---
Northwestern Public Service[8]	754,000	.89	671,060	46.77	43,551	7.21	482.73	1.5
Otter Tail[9]	1,920,128[10]	.89	1,708,914	29.56	93,064	5.43	482.67	1.3
United Power Association[11]	2,228,968	.89	1,983,781	71.53	128,535	11.04	601.00	1.8

1/ All Information for MP&L is from their Uniform Statistical Report except where otherwise noted.
2/ Square Butte 1980 Annual Report
3/ Minnkota Power Cooperative, INC. 1980 Annual Report
4/ Information for MDU is from Form #1 Report to the FERC except where otherwise noted
5/ Obtained from MDU directly
6/ Information for NSP is from their Uniform Statistical Report except where otherwise noted
7/ Obtained from NSP directly
8/ Uniform Statistical Report
9/ Uniform Statistical Report--except where otherwise noted
10/ Obtained from Otter Tail directly
11/ UPA Annual Report
12/ For Cooperatives, residential includes Farms

NOTE: There are two other cooperatives utilizing ND coal for electrical generation purposes, however, there is an insufficient amount of information available from which to perform an analysis similar to that above. The two cooperatives are Basin Electric and Cooperative Power Association.

(A2)

SUMMARY OF THE COST TO THE CONSUMER OF THE MONTANA SEVERANCE TAX

1980

Utility	Quantity[1] (1000s tons)	Cost of Montana coal (per ton) Dlvrd[1]	f.o.b.[2]	CSP[3]	Severance tax per ton[4]	Severance tax paid	Residential percentage of total Kwh Sales[5]	Average number of residential customers[5]	Average annual residential cost	Average annual residential bill	Severance tax percentage of average annua residential b
Central Illinois Light	523.8	$30.71	$11.62	$8.12	$2.44	$ 1,278,000	30.4	165,075	$2.35	$551.25	0.4
Commonwealth Edison	4,313.0	38.47	17.91	12.86	3.86	16,648,000	28.7	2,695,895	1.77	412.74	0.4
Detroit Edison	2,636.0	19.93	11.87	8.38	2.51	6,616,000	30.4	1,622,025	1.24	359.86	0.3
Houston Lighting & Power	94.4	36.89	13.59	9.64	2.89	273,000	24.3	883,755	0.08	711.28	---
Interstate Power	249.4	25.44	8.00	5.51	1.65	412,000	23.5	122,097	0.79	414.82	0.2
Lower Colorado River Auth.	925.5	43.32	20.76	14.98	4.49	4,156,000	4.1[f]	17,239[f]	9.88	454.90	2.2
Minnesota Power & Light	3,028.0	15.94	8.50	5.59	1.68	5,087,000	8.4	96,265	4.44	368.56	1.2
Montana Dakota Utilities	292.8	12.80	11.15	8.37	1.56	457,000	42.88	89,790[g]	2.18	315.62	0.7
Montana Power Company	1,777.6	7.66	6.19	4.24	1.27	2,258,000	19.98	191,025[g]	2.35	229.15	1.0
Northern States Power	7,292.3	17.81	8.45	5.87	1.76	12,834,000	27.8	958,036	3.72	332.18	1.1
Puget Sound Power & Light	1,293.4	6.19	6.19	4.24	1.27	1,643,000	50.4	480,276	1.72	371.66	0.5
Wisconsin Power & Light	1,985.1	19.63	7.73	5.36	1.61	3,196,000	28.4	264,401	3.43	405.26	0.8

[1] Delivered cost. Source: U.S. Department of Energy, Form 423 summary, unpublished computer printout.

[2] f.o.b., freight on-board, delivered cost less estimated transportation charges.

[3] C.S.P., contract sales price, fob = CSP + 0.3CSP^a + 0.005CSP^b + (0.45)(CSP)(Mill levy)^c + \$0.35^d + 0.02 f.o.b.

[4] 30 percent of CSP.

[5] Source: Company's Uniform Statistical Report to Edison Electric Institute for year ended December 31, 1980.

[a] Montana Severance Tax. [b] Resource Indemnity Trust Tax. [c] Gross Proceeds (local ad valorem property tax).

[d] Federal Abandoned Mine Reclamation Fee. [e] Federal Black Lung Tax, has an upper limit of $0.25 per ton.

[f] Source: Company's Annual report to the Economic Regulatory Administration, U.S. Dept. of Energy

[g] Source: Company's F.E.R.C. Form 1, for the year ending December 31, 1980.

(A3)

THE REAP PROJECTIONS OF THE 1976-1983 COAL DEVELOPMENT COSTS AND REVENUES TO STATE AND LOCAL GOVERNMENT FOR ALL APPROVED PROJECTS*

(INCLUDES ANG I)

STATE COSTS AND REVENUES GENERATED BY COAL DEVELOPMENT**

State Government Costs	
Direct and Industry Specific Costs (siting, regulation, reclamation and pollution control, forecasting, etc.)	$26,155,000[1]
School Aid	13,416,000
Highway Costs	74,641,000
Other State Government Costs	48,485,000
Transfers to Local Government	3,467,000
Total State Government	$166,164,000
State Revenues (excluding severance/conversion tax revenues)	
State Income Taxes	$12,548,000
Sales & Special Taxes	31,152,000
Highway Taxes	10,782,000
Total State Revenues	$54,482,000
Gross deficit from Coal Development to State Government (costs less revenues)	$111,682,000

[1] From estimates furnished by state agencies and departments. Does not include Federally funded projects.

LOCAL GOVERNMENT COSTS AND REVENUES GENERATED BY COAL DEVELOPMENT

Local Government Costs	
Schools	$21,755,000
Law Enforcement & Public Safety	5,806,000
City & County General Government	34,881,000
Social Services	696,000
Streets	1,066,000
Debt Service (new capital expenditures for water, sewer and waste disposal)	34,196,000
Total Local Government	$98,400,000
Local Revenues (excluding severance/conversion tax revenues)	
Property Tax	$ 6,639,000
State Educational Aid	13,432,000
State & Federal Transfer	4,517,000
User Fees & Special Assessments	29,247,000
Total Local Revenues	$53,835,000
Gross deficit from Coal Development to Local Government (costs less revenues)	$44,565,000

Gross deficit from State Government without coal revenues	$111,682,000
Gross deficit from Local Government without coal revenues	44,565,000
Coal Conversion & Severance Tax Revenues needed to meet impact 1976 - 1983	$156,247,000

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*Does not include costs for projects completed prior to 1975.

**Does not include costs for negative impact of air and water pollution, long-term loss of productivity of land, aquifer damage, or potential climatological changes.

1/30/79

(A4)

THE COMBINED DEFICITS TO STATE AND LOCAL GOVERNMENT FROM 1976-1983 COAL DEVELOPMENT UNDER EXISTING AND PROPOSED COAL TAX LAWS FOR ALL APPROVED PROJECTS

(INCLUDES ANG I)

HB 1257
85¢ PER TON WITH 1¢ INCREASE FOR EVERY 4 POINT INCREASE IN WHOLESALE PRICE INDEX

1976-1983 Gross Deficit – State & Local Government		$156,247,000
Projected Coal Severance and Conversion Taxes	$130,223,000	
Less Allocation to Trust Fund	17,636,000	
Available to Meet Impact		112,587,000
NET SHORTFALL		$ 43,660,000

(A5)

RESOLUTION

MIDWESTERN STATES ASSOCIATION OF TAX ADMINISTRATORS

August 14, 1981

WHEREAS, a question has been raised as to whether the United States Congress has the authority to restrict or limit state tax policy; and

WHEREAS, the case of Complete Auto Transit Incorporated v. Brady, 430 U.S. 274, properly and adequately sets out the test under the Commerce Clause of the United States Constitution for reviewing state tax policy; and

WHEREAS, legislation has been introduced in the United States Congress which may or will act to restrict state tax policy; and

WHEREAS, states strongly oppose any attempt by the United States Congress to restrict the states' sovereign right to establish their own tax policy;

NOW THEREFORE, we the members of the Midwestern States Association of Tax Administrators oppose any intrusion by the United States Congress on the states' sovereign right to determine their own tax policy.

PREPARED STATEMENT OF CLYDE E. ALLEN, JR.

Mr. Chairman and members of the committee,

I am here today to voice my support for Senate File 173, a measure designed to limit the level of severance taxes changed on federally-owned coal to 12.5% of the value of the coal.

Today I shall express my concerns over the threats I recognize in the coal severance tax policies being practiced by the western coal states. As Commissioner of Revenue in a state with a substantial history of mineral development, I have some empathy with the states of Montana, Wyoming and North Dakota as they attempt to forge fiscal policies that provide for adequate health, education and social services in the coal-impact regions. Indeed, Minnesota history records the swinging pendulum of boom and bust that can haunt the fiscal integrity of mining communities as well as their citizens. For the past 100 years severance taxes in various forms have been levied upon the iron ore mined in Minnesota. Historical and current mineral taxation policies in this state have guided me in the formation of my opinions relative to the prospect of limiting state severance taxes on federally-owned coal.

First of all, I believe in the importance of allowing state and local governments the privilege of managing their internal affairs, including tax policy. However, there are several leading reasons why it is legitimate for the Congress to intervene in this instance. The fact that the coal is nationally owned and a vital resource makes it reasonable for the tax policies of the western coal states to be scrutinized by outsiders. In addition, I distinguish between the prerogative of states to levy taxes on businesses or individuals within their borders and policies, which, by design, almost entirely tax individuals beyond their borders. I feel the federal government has the right to maintain vigilance on situations that involve such an export of tax burden.

My analysis of the severance taxation policies of the western coal states leads me to conclude that there appears to be a lack of countervailing influences on the establishment of severance tax rates. I'm not sure that there is currently any effective control preventing the western coal states, either singly or in concert, from raising their severance tax rates to 40% or even 50% of mine-mouth value. Federal environmental energy policies have identified and somewhat narrowly prescribed that the low-sulfur coal of the west will be used for future power generation. This is the coal that will be used; and utilities with long-term contracts with severance tax pass-through provisions will burn it to produce electricity. There will be little opportunity to consider substitute fuels in this progression of events. The apparent lack of countervailing influences on the establishment of a severance rate has proven to be too great a temptation to the producing states. They appear to be willing to export their tax burdens far in excess of legitimate needs in the coal-impact areas of their states.

Minnesota taconite faces fierce competition, not only from other states, but also from abroad. Minnesota's mineral policy has been formulated to serve our local interests and help our taconite industry remain competitive. Our legislature is indeed sensitive to the prospects of Minnesota taconite losing its market share to other states or nations. I feel this countervailing restraint on our taxation policy has helped to keep our effective severance rate on taconite at 4.9% of the value of the taconite in 1980.

In the 1980 taconite production year, Minnesota collected $87,200,000 at this "low" rate. A majority of taconite production tax revenues find their way to the localities of the mining activity as a substitute for property taxes on the mining industry. Our occupation tax on taconite and iron ore serves as a substitute for an income tax on the mining industry. The tax is handled in this fashion by convenience due to the vertical integration found in the steel industry. Our royalty taxes are often a pre-development occupation tax which, as previously described, is a substitute for an income tax. The revenues from these taxes largely find their way to the mining communities and provide for current needs of roads, schools and social services. Some funds are earmarked to aid research efforts in new mining technologies and marketing techniques, while other funds are set aside for long-range economic and social planning in the mining regions. I find it easy to defend the uses of Minnesota mineral tax revenues.

If our steel industry were nationalized, and if Congress mandated that Minnesota taconite were to be used in the blast furnaces, our mineral taxation policies would lose touch with the countervailing influences of the marketplace. If Minnesota were to hypothetically lose this restraint in its taxation policy, we, as a state, could be tempted to try to export excessive tax burdens to others outside our borders. In the same hypothetical setting, we could conceivably adopt the net effective severance tax levels of Montana and annually generate an additional $398,800,000, representing a 457% increase in severance tax collections. With these additional funds, I'm sure we could find some new approaches to tax relief; and we might even be able to set up substantial trust funds.

My point is that, as a state, we could shift our burdens outside our borders to an unreasonable degree. Then Minnesota, with potentially lower property and corporate income taxes, would have a more enviable tax climate with which to woo new industry. Such an advantage would be unfair because it would have been won at the expense of others outside our borders.

My fears are that the western coal severance revenues, which exceed the reasonable present and future needs of the impact areas, will provide vast amounts of state and local tax relief that will inordinately favor their business tax climate at someone else's expense.

Analysis of the United States Department of Commerce publication "State Tax Collections," reveals that nationally all severance taxes have recently shown dramatic increases. From 1979 to 1980 an increase of 46.2% was recorded for revenues generated by this group of taxes. Alaska's oil and gas production taxes were the most dramatic with nearly a three-fold increase in one year, representing a jump to $506,163,000 from $173,491,000. Montana also showed a substantial increase from 1979 to 1980 with coal production taxes rising 78.7%. This particular increase (from $42,049,000 to $75,125,000) caused coal revenues to represent 17.2% of total Montana revenues from 10.5% the previous year. Indeed, Montana coal severance taxes represent the most powerful growth aspect in Montana revenue generation. In Wyoming a smaller increase occurred, with total severance taxes currently representing 27.2% of all collections from a previous share of 25.5% of all collections. From 1979 to 1980 total Wyoming collections increased 13% with severance taxes from all sources increasing 21%. North Dakota's coal severance tax picture to date has been overshadowed by collections from oil and gas severance revenues. North Dakota's coal severance collections grew a healthy 19% from 1979 to 1980, although coal severance taxes still represent only 3.8% of her total collections.

As I stated earlier, I feel it is legitimate for the Congress, in this case, to guide the tax policies of the states. I feel I have identified several conditions unique to this situation that warrant this intervention. I conclude that, if a balance cannot be struck on this question of fair yet adequate severance tax levels. the season will be open on a vigorous round of schemes to export taxes. Of course, states would then attempt to retaliate upon one another by other tax methods, so that in the end economic barriers would emerge. Economic barriers to trade erected by the states would ultimately cause severe misallocations of resources and the general prosperity of all the states would suffer.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE
MINERALS TAX DIVISION
LIBRARY BUILDING
EVELETH MINNESOTA 55734

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TO: The Honorable Dave Durenberger
United States Senate
Chairman, Subcommittee on Intergovernmental Relations

FROM: Dwight E. Lahti
Minerals Tax Administrator
Minnesota Department of Revenue

SUBJECT: Oral Statement to the Subcommittee on Fiscal Disparities, State Energy Taxation, and Tax Competition
August 31, 1981
St. Paul, Minnesota

ORAL STATEMENT

AN EQUAL OPPORTUNITY EMPLOYER

SENATOR DURENBERGER HAS ASKED ME TO CLARIFY MINNESOTA'S MINERALS TAXES, WHAT THEY ARE AND HOW THEY WORK. HE HAS ALSO EXPRESSED AN INTEREST IN MINNESOTA'S APPROACH TO TAXING COPPER-NICKEL. MY WRITTEN STATEMENT TO THE SUBCOMMITTEE, DATED AUGUST 20TH, COVERS THESE TWO SUBJECTS AND MY ORAL STATEMENT TODAY IS INTENDED TO SUMMARIZE AND SUPPLEMENT MY EARLIER WRITTEN STATEMENT.

THE CURRENT MINERALS TAX STRUCTURE OF MINNESOTA PROVIDES FOR 14 TAXES THAT APPLY EITHER DIRECTLY OR INDIRECTLY TO MINING AND/OR MINERALS. IN ORDER TO HELP UNDERSTAND THE RELATIONSHIP OF OUR TAXES TO THOSE OF OTHER STATES, I HAVE CLASSIFIED THEM INTO THREE COMMONLY KNOWN GROUPS, EXCISE, PROPERTY AND INCOME. OUR EXCISE GROUP INCLUDES TAXES ON SEVERANCE, ON SALES AND USE, AND ON THE PAYMENT OF ROYALTIES FOR THE PRIVILEGE TO EXPLORE AND/OR MINE. AT THIS POINT PLEASE REFER TO THE OUTLINE BELOW FOR A CLEARER UNDERSTANDING OF WHAT EACH GROUP INCLUDES BY SPECIFIC TAX TYPE:

I. EXCISE TAX GROUP
  A. TAX ON SEVERANCE (OR FORM OF)
    1. NATURAL ORE/TACONITE OCCUPATION TAX
    2. COPPER-NICKEL OCCUPATION TAX

  B. TAX ON SALES AND USE
    3. MINNESOTA SALES AND USE TAX

  C. TAX ON PAYMENT OF ROYALTIES
    4. NATURAL ORE/TACONITE ROYALTY TAX
    5. CU-NI ROYALTY TAX

II. PROPERTY TAX GROUP (OR FORM OF AD VALOREM)
  6. TACONITE PRODUCTION TAX
  7. SEMI-TACONITE PRODUCTION TAX
  8. CU-NI PRODUCTION TAX
  9. AD VALOREM TAX ON UNMINED NATURAL ORE
  10. TAX ON UNMINED TACONITE
  11. TAX ON SEVERED MINERALS INTEREST
  12. CU-NI PROPERTY TAX (ON SMELTER AND REFINERY)

III. INCOME TAX GROUP (OR FORM OF)
  13. GROSS EARNINGS TAX ON TACONITE RAILROADS
  14. CORPORATION INCOME TAX ON CU-NI

TAXES MAY ALSO BE GROUPED ACCORDING TO HOW THEY ARE DISTRIBUTED, THAT IS, EITHER TO THE STATE GENERAL FUND OR TO LOCAL TAXING DISTRICTS. LOOKING AT MINNESOTA'S STRUCTURE FROM THIS VIEWPOINT WE FIND THAT THE MOST SIGNIFICANT TAX IN REVENUE DOLLARS GENERATED IS THE TACONITE PRODUCTION TAX WHICH FOR PRODUCTION YEAR 1980 PRODUCED 87.2 MILLION DOLLARS. THIS TAX IS IN LIEU OF PROPERTY TAX AND ITS GREATEST PART IS DISTRIBUTED TO LOCAL TAXING DISTRICTS.

WITH THE EXCEPTION OF THE PRODUCTION TAXES, THE PROPERTY TAX GROUP FOR THE MOST PART IS ADMINISTERED BY THE COUNTY. THE STATE ONLY PARTICIPATES IN ESTIMATING THE AMOUNT OF RESERVE AND ITS VALUE. OF THE REMAINING TAXES IN THE PROPERTY TAX GROUP, THE AD VALOREM TAX ON NATURAL ORE IS THE MOST SIGNIFICANT IN DOLLARS. IN 1980 IT GENERATED APPROXIMATELY 4 MILLION DOLLARS IN PROPERTY TAX FOR LOCAL TAXING DISTRICTS.

OF THE REMAINING TAXES, THE OCCUPATION, SALES, ROYALTY AND GROSS EARNINGS TAXES ARE DEDICATED TO THE STATE GENERAL FUND. FOR PRODUCTION YEAR 1980 THESE TAXES GENERATED APPROXIMATELY 30.2 MILLION DOLLARS.

WITH THAT FOR INTRODUCTION LET ME MOVE ON TO A SECOND POINT. I THOUGHT IT MIGHT BE OF INTEREST TO THE SUBCOMMITTEE TO KNOW WHAT PART OF THE VALUE OF A TON OF TACONITE PELLETS, RESTING AT THE END OF THE PELLETIZING PROCESS IN MINNESOTA, REPRESENTS THE PRODUCER'S COST FOR PRODUCTION TAX AND OCCUPATION TAX. ON AN INDUSTRY WIDE BASIS FOR PRODUCTION YEAR 1980, THE PRODUCTION TAX IS APPROXIMATELY 4.9% OF THE VALUE OF THE PELLET AND THE OCCUPATION TAX IS APPROXIMATELY 3/4 OF 1% OF THE PELLETS VALUE.

NOW LET'S TURN OUR THOUGHTS TO COPPER-NICKEL. AGAIN FROM SENATOR DURENBERGER'S LETTER, I CAN SEE THE SUBCOMMITTEE'S INTEREST IN COMPARING VARIOUS STATE'S TAX STRUCTURES AND POLICIES. IN THE PAST EIGHTEEN MONTHS WE HAVE DONE MUCH WORK IN TRYING TO COMPARE MINNESOTA'S CURRENT TACONITE TAX POLICY TO OUR EXISTING COPPER-NICKEL TAX LAW. WE WERE DOING THIS IN ORDER TO DETERMINE WHAT THE MINNESOTA COMPARATIVE, OVERALL TAX BURDEN MIGHT BE ON THESE TWO MINERALS.

LOGICALLY, IT MAY SOUND VALID TO COMPARE COPPER-NICKEL TAX TO TACONITE, ESPECIALLY WHEN THE MOST LIKELY REFERENCE POINT THAT A MINNESOTAN WOULD EASILY UNDERSTAND IS TACONITE. YET, EVEN IN A TWO MINERALS TAX COMPARISON, IN THE SAME STATE, THIS BECOMES AN EXERCISE OF COMPARING APPLES TO ORANGES. SO, GREAT CARE HAD TO BE TAKEN IN REDUCING THE COMPARISON TO A COMMON BASE.

I WOULD LIKE TO SHARE SOME OF THE PROBLEMS WE HAD IN MAKING OUR COMPARISONS:

- ONE OF THE COMMON MISUNDERSTANDINGS ABOUT COPPER SMELTING AND REFINING IS TO PARALLEL THAT PROCESS TO TACONITE BENEFICIATION. THESE TWO PROCESSES ARE ENTIRELY DIFFERENT. THE TACONITE BENEFICIATION TAKING PLACE IN MINNESOTA ONLY ADDS VALUE TO AN ENHANCED FORM OF WHAT STILL COULD BE CONSIDERED A NATURAL, RAW RESOURCE (A CONCENTRATE). WHEREAS, THE SMELTING AND REFINING PROCESS FOR COPPER AND NICKEL BRINGS A COPPER AND/OR NICKEL CONCENTRATE TO A FINISHED METAL AND READIES IT INTO MARKETABLE FORM, IN THE SENSE OF A BUY AND SELL MARKET. MAKING THIS DISTINCTION IS IMPORTANT FOR MANY REASONS. FOR EXAMPLE, THE IMPORTANCE OF RECOGNIZING THE DIFFERENCE IN PRODUCTION COSTS IS NECESSARY IF A TAX WERE TO BE BASED ON NET TAXABLE VALUE, MEANING CRUDE ORE LESS PROCESSING COSTS.

- ANOTHER PROBLEM IS THE DIFFERENCE IN HOW TACONITE PELLETS VERSUS COPPER AND NICKEL ARE QUOTED FOR MARKET. LET'S REVIEW FOR A MINUTE. SIMPLY STATED, THE OCCUPATION TAX IS BASED ON THE VALUE OF CRUDE ORE PRODUCED AT THE EDGE OF A MINE IN MINNESOTA. A MARKET PRICE FOR CONCENTRATES THEN WOULD BE A LOGICAL PLACE TO BEGIN THE VALUING PROCESS.

  FOR TACONITE PELLETS THERE IS A THEORETICAL MARKET VALUE QUOTED AS THE "LAKE ERIE VALUE" WHICH TRANSLATED MEANS THE VALUE OF PELLETS RESTING (UNFORTUNATELY RATHER THAN IN MINNESOTA) ON A DOCK AT A LAKE ERIE PORT. ALTHOUGH ADMINISTRATIVELY IT IS

DIFFICULT TO MODIFY THIS VALUE IN ORDER TO EXPRESS IT IN TERMS OF VALUE OF ORE AT A MINNESOTA MINE, IT CAN STILL BE DONE MORE EASILY THAN IT COULD BE FOR COPPER.

LET ME EXPLAIN FURTHER. FOR COPPER AND NICKEL THERE IS NO QUOTED PRICE FOR CONCENTRATES BUT INSTEAD PRICES ARE QUOTED IN TERMS OF FINISHED METAL. CONSEQUENTLY, IF SMELTING WERE TO TAKE PLACE OUTSIDE OF MINNESOTA, IT WOULD BE EXTREMELY DIFFICULT TO ISOLATE THE PROCESSING COSTS OF THE FINISHED METAL RELATIVE TO THE VALUE OF PRODUCTION FROM MINNESOTA CONCENTRATES. YET, IN ORDER TO EXPRESS COPPER-NICKEL ORES IN TERMS OF VALUE AT A MINNESOTA MINE THIS PROCEDURE WOULD BE NECESSARY.

- THE LAST PROBLEM, WHICH IS RATHER MINOR, YET UNLESS IT IS TAKEN INTO CONSIDERATION COULD CAUSE DIFFERENCES IN COMPARISON. IT IS SOMETHING AS SIMPLE AS WEIGHT. COPPER CONCENTRATES ARE MEASURED IN CONVENTIONAL TONS. IN OTHERWORDS, 2,000 POUNDS PER TON. TACONITE PELLETS ARE MEASURED IN LONG TONS OR 2,240 POUNDS PER TON. ONE MUST BE CAREFUL IN COMPARING CONCENTRATES TO MODIFY THEM TO THE SAME WEIGHT BASE, ESPECIALLY WHEN THE IMPACT OF TAX MIGHT BE MEASURED BY TON.

MY CLOSING COMMENTS DEALS WITH REVIEWING A FEW PIECES OF MINNESOTA LEGISLATION THAT WERE INTENDED TO STIMULATE CONTINUED MINERALS DEVELOPMENT.

THE FIRST PIECE OF LEGISLATION THAT I WOULD LIKE TO MENTION DEALS WITH SPECIAL PROVISIONS THAT WERE GRANTED TO THE TACONITE INDUSTRY TO EXEMPT THEM FROM SALES TAX FOR CONSTRUCTION MATERIALS

USED IN EXPANDING MINNESOTA'S IRON RANGE TACONITE PELLET CAPACITY. THIS EXPANSION EXEMPTED APPROXIMATELY ONE BILLION DOLLARS OF CONSTRUCTION MATERIAL FROM SALES TAX. THE EXEMPTION RAN FROM JANUARY 1, 1974 TO JULY 1, 1978.

THE NEXT PIECE OF LEGISLATION I WOULD LIKE TO DISCUSS WAS PASSED IN 1963. IT HAS COME TO BE KNOWN AS OUR "TACONITE AMENDMENT" WHICH THROUGH LEGISLATION PROVIDES FOR A 25 YEAR PERIOD DURING WHICH A TACONITE PRODUCER WOULD PAY AN AMOUNT OF OCCUPATION TAX NO GREATER THAN WHAT A MANUFACTURING CORPORATION MIGHT PAY UNDER THE INCOME AND EXCISE LAWS OR WHAT THE PRODUCER WOULD HAVE OTHERWISE PAID UNDER THE 1963 OCCUPATION TAX LAWS. PORTIONS OF THIS LEGISLATION ARE PRESENTLY BEING LITIGATED IN THE COURTS.

MY LAST EXAMPLE OF SPECIAL LEGISLATION TO ENCOURAGE MINING, DEALS WITH ANOTHER SALES TAX EXEMPTION. THE TACONITE INDUSTRY IS EXEMPT FROM PAYING SALES TAX ON THE MILL LINERS AND ROD AND BALLS CONSUMED IN PRODUCTION BECAUSE THESE ARE SUCH HIGH COST ITEMS AND ARE CONSUMED RAPIDLY.

FINALLY OUR TAX LAWS ALLOW CREDITS FOR THE UTILIZATION OF LABOR, RESEARCH, AND SMELTING AND REFINING IF SUCH COSTS ARE INCURRED HERE IN MINNESOTA. FOR EXAMPLE, THE EFFECT OF THE CREDIT FOR LABOR REDUCES THE STATUTORY RATE OF OCCUPATION TAX ON TACONITE FROM 15% TO 6.75%.

MR. CHAIRMAN THAT CONCLUDES MY ORAL STATEMENT TO THE SUBCOMMITTEE.

DEL:VP

Senator **Durenberger**. The hearing is now adjourned.

[Whereupon, at 5:20 p.m., the subcommittee was recessed, subject to the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

STATEMENT OF U. S. SENATOR ALAN K. SIMPSON OF WYOMING

before the
Intergovernmental Relations Subcommittee
of the
Senate Governmental Affairs Committee
July 16, 1981

MR. SIMPSON. Mr. Chairman, the debate on federal action to limit the taxing ability of the sovereign states has been one of the recent persistent issues before the Congress. The efforts and arguments of its proponents in the last Congress were unsuccessful, and I believe that logic and horse sense will again prevail in this session.

The justification for sovereign states to levy a mineral severance tax on the extraction of ~~their~~ mineral resources is defensible from many points. Indeed, it was truly heartening to read the U.S. Supreme Court decision which held that the Montana severance tax does not violate the Commerce and Supremacy Clauses of the United States Constitution.

The purpose of my comments today will be to respond to the overgeneralized assumptions and incorrect information that have been ladled out to the public regarding the purpose and rate of mineral excise taxation on coal resources levied by the western states.

The first point that should be made concerns the intent of Wyoming's people and lawmakers in levying a mineral excise tax on coal. The people of Wyoming and the Wyoming State Legislators have in no way made a conscious, premeditated, deliberate or devious effort to levy a mineral excise tax on coal in order to inflict an unfair burden on electrical rate payers in other states. The present rate of the coal mineral excise tax in Wyoming was set in 1977 at 10.5 percent and it continues at that rate -- not the 17 percent figure as often stated by sponsors of anti-severance tax legislation who want to impose a federal limit on the amount of severance tax that a State can place on production within its boundaries.

Of the 10.5 percent of state mineral excise tax which Wyoming has adopted, fully 6.5 percent goes directly to "earmarked" accounts that are specifically targeted for the purpose of relieving the various problems that are directly or indirectly associated with the rapid industrialization of Wyoming energy development. These coal tax revenues finance such traditional government functions as the constructing of public utilities, providing for public health and recreation, the development of water resources, and the building of highways and bridges. Certainly any attempt by the Federal Government to limit the ability of the state to respond to these dramatic social, economic and environmental impacts would fly directly in the face of the federal system of government -- as envisioned by our Constitution.

On this point alone these limitation proposals are fatally flawed. It is not a proper exercise of the enumerated powers which Congress has been granted under the Constitution to be able to override state sovereignty when exercising its otherwise "plenary powers" to tax or regulate commerce.

I should also point out that the severance tax structures of both the State of Wyoming and the State of Montana do not impose a tax burden that discriminates against "out of state" coal users in favor of its own residents or their local economies.

In testimony before this Congress, Hubert H. Nexon, Senior Vice President of Commonwealth Edison Company, who is also President of the National Coal Consumers Alliance, decried the process of allowing state severance taxes to be passed on to electrical users in coal consuming states. But I would point out to my colleagues that it is a fundamental principle of equity that those individuals who benefit to the greatest degree, and in the most direct fashion, have the responsibility of assuming the burden of paying for those benefits. An application of that equitable principle to the coal tax situation would assure that those electric rate payers who benefit from power generated from the combustion of coal resources mined in another state would assume a portion of the cost of providing for those fuel resources.

The social and environmental costs which western states are expected to bear in the development of coal within the scope of a national energy policy are physically visible to anyone who has seen the surface mines, power plants, coal unit trains, trailer camps and the modular schools in my own State and neighboring areas in Colorado, Montana, North Dakota and New Mexico.

The graphic and principal costs of this growth are being borne by producing states and the mineral severance tax only assists in distributing a small portion of those costs to the consuming states. The commercial relationship between the coal company, the utility and the state regulatory commission, in conjunction with the fuel supply agreements and automatic fuel escalation tariffs provide for the direct pass through of those costs and expenses. Tax reformers should direct their efforts at such institutional relationships within their own states before proposing to trample on the sovereignty of their neighbors.

Contrary arguments seem to ignore the basic proposition that the coal producing states clearly recognize that there is a more compelling state interest in a strong local economy providing jobs, than for any selfish interest to just lay on a heavier and more burdensome severance tax. The ability to maintain coal markets and the relationship that severance tax may have to the competitiveness of western coal is of paramount concern in each instance when the issue of severance tax has come before the Legislature and the people of the State of Wyoming.

Mr. Chairman, I urge your Subcommittee to develop a complete picture of the real cost components which account for the higher delivered price of coal to those districts where sponsors of severance tax limitation legislation reside. In 1980, the average price for a ton of Wyoming coal was about $8.28 with a current severance tax at 10.5 percent on the contract price of the coal. The average severance tax per ton of Wyoming coal will amount to .87¢. If local property taxes are added to the level of state mineral severance tax, the total tax levied on a ton of coal will amount to $1.40.

Then, do please consider the coal haulage rates charged by railroads. For example, the freight charges are $19.25 per ton to haul coal from the Belair Mines south of Gillette, Wyoming, to a power plant in Elmendorth, Texas. Rail charges generally will range from $12 to $19 per ton for markets served by Powder River Basin coal, and rate increases are of course anticipated. In fact, some coal haulage rates have already risen over 50 percent between 1973 and 1979.

Obviously, transportation costs then have a much greater influence on the cost of marketability of western coal than any severance tax.

This Subcommittee should also consider the proper allocation to such coal resource extraction cost components as:

1. Mining costs
2. Reclamation costs*
3. Surface owner payments*
4. Landowner royalties*
5. Blacklung insurance*
6. Abandoned mine reclamation funds charges*
7. Bonding costs*
8. Federal withholding taxes*
9. Workmen's Compensation*
10. Federal unemployment tax*
11. Union pension plans
12. Union dues
13. Construction of the energy producing facility

14. Rail transportation charges
15. Return on investment
(* Required or determined by federal law)

All of these factors -- in addition to state severance and ad valorum tax -- must be blended in to be able to determine where the real "unfair burden" on coal costs has crept into the consumer's electric bill. It is high time to stop attempting to fool the consumer with charades about what causes their electric bills to be so high.

Consideration of the per kilowatt hour cost of electricity makes it necessary that your Committee also consider the relationship between the cost of fuel resources and these many factors which are cranked into the utility rate base. Specifically, I urge you to consider the cost of power plant construction, compliance with state and national environmental controls, and labor and other costs. All of these cost factors are more significant than any state severance taxes -- perhaps not more emotionally or dramatically significant -- but certainly more realistically and honestly significant.

Consumers all across America are disturbed by their ever-increasing utility bills. Consumers should be educated by utilities and utility commissions in order that they can see for themselves what an insignificant role severance taxes play in sky-rocketing homeowner utility bills.

Assuming, a 7,000 kilowatt hour per year electric consumption -- which is the maximum average consumption of the households in the United States -- the Wyoming severance and ad valorum tax on coal would add approximately .53¢ to the monthly electric bill. In areas where electricity consumption is higher, due to air conditioning or electric heating, that amount would be proportionately greater. On the other hand, an electricity consumer in Elmendorth, Texas, will find that $7.22 of this monthly electric bill is due to coal transportation costs alone -- without even considering higher than average consumption rates. Who is being fooled in this process? It is the consumer who is stirred by the presentation of distorted facts.

From the perspective of national policy, legislation to limit state severance taxes would pose serious questions about the role of Congress in limiting state taxes of any sort where there is an issue of consideration of the tax impact on regionally located production centers. This would require Congress to consider whether or not the total array of state taxes should be considered. For instance, those states located in the midwest -- which is the regional center of production for automobiles, heavy machinery and other manufactured goods -- may, in fact, be using their state corporate and possessory interest tax structures to export their tax burden to consumers in other parts of the country.

Adoption of tax limiting legislation would pose a dangerous national precedent. For if Congress is able to restrict the amount of taxation which the mining states are able to levy on coal resources why then should not Congress also act under its commerce powers to restrict the level of state taxation in the farm belt states, in the manufacturing states, the timbering regions of America, and any other state which sustains within its border a regional or national center of production?

In conclusion I would like to point out that for the electrical rate payer -- and I believe that is whose interests are at issue -- coal from Wyoming and Montana is the best bargain available. On a dollar per million BTU basis, the cost of production, including taxes, for western coals is less than half the cost from midwestern and eastern mines.

The following table demonstrates this point.

AVERAGE PRODUCTION COSTS EXPRESSED
AS $/MILLION BTU FOR STEAM COAL*

State	1976	1978
Kentucky	.79	.95
Indiana	.54	.79
Ohio	.67	.90
Illinois	.71	.91
Montana	.25	.37
Wyoming	.33	.43

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*Source: DOE, Energy Information Agency
1976 DOE/EIA 0118/1(76), 1978 Form EIA7

Pre-emption of the ability of states to function within their most traditional areas of public finance can only produce an extremely negative and uncooperative atmosphere for coal development that certainly can be counterproductive to our overall energy policy mission.

State of Rhode Island and Providence Plantations
EXECUTIVE CHAMBER, PROVIDENCE

J. Joseph Garrahy
Governor

July 18, 1981

The Honorable David F. Durenberger, Chairman
Senate Intergovernmental Relations Committee
Room 507 Carroll Arms Building
300 First Street N.E.
Washington, DC 20510

Dear Mr. Chairman:

I am pleased to submit the attached testimony on state energy taxes to your committee and regret that I was unable to appear in person at the hearings on July 16. We appreciate very much the attention of the committee to this important problem. I would be happy to be of any possible assistance.

Sincerely,

J. Joseph Garrahy
GOVERNOR

STATE ENERGY TAXES

Testimony of

Honorable J. Joseph Garrahy
Governor, State of Rhode Island

Submitted to the

Senate Intergovernmental Relations Committee

July 16, 1981

Senator Durenberger and the Intergovernmental Relations Committee are to be congratulated for the timeliness of the hearings on the vital topic of state imposed taxes on energy resources. This problem has recently begun to loom large in the minds of all of us concerned with the well-being of our country. It is our contention that the imbalance which results from the imposition of large energy severance taxes threatens rich and poor states alike by weakening the federal system itself.

The wide difference in the costs of energy between the resource rich and resource poor regions of our country is sapping the economic strength of the Northeast. This energy cost differential is compounded by the revenues which energy producing states derive from severance taxes.

The problem lies not in the legitimacy of the severance tax concept but in the magnitude of the numbers. We in Rhode Island agree that states should be reasonably compensated to cover the full costs of the mining impacts for the depletion of their natural, valuable resources. Left unchecked, however, by federal control, those states with exportable quantities of oil or gas or coal can and do derive revenues from their extraction which go far beyond reasonable compensation to a point which is dangerously exploitive of consumers in other states.

You are well aware of the size of these huge revenues - more than $2 billion in 1978, with far larger amounts anticipated in years to come. We need not reiterate the exacerabated situations which develop when these enormous sums flow into a few states, often those with low populations, providing bloated state budgets in startling contrast to the leanness of public monies available in the resource poor areas, which are often characterized, at least in the northeast, by dense populations and aging cities. As this disparity increases, a continuing spiral develops in which the energy rich states are able to lower taxes, attract industry and improve public services at the expense of the energy poor states which must raise taxes, lose needed industry, and struggle to provide decent services to their citizens and meet their other basic responsibilities. The massive transfer of funds through severance taxes indeed threatens the entire social and economic fabric of our region.

It is essential to the stability of our democracy that these egregious regional energy disparities not be allowed to continue to develop. What is required now is Congressional action. We in Rhode Island strongly support Senator Durenberger's legislation, S178, currently before the Senate Energy and Natural Resources Committee, which would limit state severance taxes on coal mined from federal or Indian land to 12.5%. We would go much further, and suggest that the committee address itself to drafting legislation which would set reasonable state severance taxes based on the extraction of oil, gas and other minerals as well.

The impediments these taxes offer, in the amounts presently being collected, present, in the words of Justice Byron White, "an intolerable and unacceptable burden on commerce." They erode the regional balance our federal government set out to establish. They set the tone for retaliation and economic warfare amongst the states which will in the long run be as detrimental to those that presently appear to be profiting as to us now in the Northeast. We strongly believe that no federal agenda can seriously entertain the notion of abandonment of the regions with fewer energy resources. It is surely a federal responsibility to ensure that conditions which would require this not be allowed to continue.

TESTIMONY SUBMITTED BY GOVERNOR TED SCHWINDEN OF MONTANA TO THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS OF THE U.S. SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS, SUBMITTED TO THE RECORD, THURSDAY, JULY 16, 1981

Chairman Durenberger, members of the committee, the issues you are considering this week must be discussed in the context of the impact on all states, not just those that levy severance taxes.

In these days of "new federalism," Congressional infringement on the fundamental rights of any state is unacceptable. President Reagan and the nation's governors have expressed a mutual commitment to reduce the role of the federal government in state affairs. At a time when many other federal decisions are giving states more authority, it is inappropriate for Congress to interfere with such a basic state right as taxation. Americans, whether they are Montanans, Minnesotans, or Texans, do not want their lives or their tax policies dominated by Washington!

A Congressional decision to establish federal funding formulae on the basis of severance taxes, or to place a cap on those taxes, threatens all state and local taxes. If Congress sets the precedent now of intervening in or regulating one kind of state tax, then where will it stop? Will Congress ultimately set limits on state property, income or sales taxes?

The Reagan administration and the Congress are currently considering budgetary initiatives by which states will be required to bear a greater portion of the cost of programs previously shared with the federal government. It makes neither common sense, nor "dollars-and-cents," to restrict a state's ability to generate revenue to defray the general costs of government while at the same time federal actions are creating new financial burdens for state governments.

Montana is not getting rich at the expense of energy poor states. Montana's severance tax has an insignificant impact on consumers in or out-of-state, amounting to only .2 to 1.9 percent of a Midwestern consumer's annual utility bill. And, despite transportation costs ranging from 49 to 67 percent of its delivered cost, Montana coal sells as far east as Michigan and Arkansas because of its low price.

The U.S. Supreme Court on July 2, 1981, found that Montana's coal severance tax does not violate the Commerce Clause or the Supremacy Clause of the U.S. Constitution. "We are not convinced," the Court said, "that the Commerce Clause, of its own force, gives the residents of one State the right to control . . . the terms of resource development and depletion in a sister State." Federal preemption of a state's right to levy a severance tax repudiates the concept of federalism, and denies the people of a state their constitutional right to establish responsible tax policy within their borders.

I am not unreasonable in urging Congress to refrain from taking this unprecedented step of intruding into an area of fundamental state rights, and I hope your committee and the Congress will reject all attempts to preempt the taxing authority of states under the Commerce Clause. And, if further hearings are to take place on this issue, I respectfully suggest they be held regionally throughout the country so that citizens of every state could more readily voice their opinions on this issue.

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The Big Sky Country

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COMMITTEES
TAXATION
STATE ADMINISTRATION
REVENUE OVERSIGHT

July 22, 1981

PREPARED TESTIMONY - HEARING ON THE UNITED STATES SUPREME COURT CASE OF COMMONWEALTH EDISON v. MONTANA DEALING WITH MONTANA'S COAL SEVERANCE TAX

My name is Thomas E. Towe. I am a State Senator from Billings, Montana, and I was the chief sponsor of Montana's coal tax legislation enacted in 1975. The subject of limiting a state's authority to levy a severance tax on coal, or for that matter, the state's authority to levy any kind of a tax, greatly concerns me. While the Supreme Court Justices in Commonwealth Edison Co. v. Montana (decided July 2, 1981) mentioned Congress and bills currently pending to limit the coal tax, I think it would be very unwise for Congress to take such action. It would be a very dangerous precedent.

Except on such specific matters as airport taxes and the taxing of a federal instrumentality, the state's sovereign authority and power to tax its own citizens has not been restricted by Congress. Should Congress now attempt to limit the general taxing authority of a state, it could signal the beginning of a substantial encroachment on the rights of sovereign states to take care of their own needs and to govern their own destiny. Indeed, this point seems to be recognized by the United States Supreme Court. Justice Marshall, writing for the majority, stated as follows:

> "Rather, appellants assume that the commerce clause gives residents of one state a right of access at 'reasonable' prices to resources located in another state that is richly-endowed with such resources, without regard to whether and on what terms residents of the resource-rich state have access to the resources. We are not convinced that the

> commerce clause of its own force, gives the residents of one state the right to control in this fashion the terms of resource development and depletion in a sister state." Commonwealth Edison Co. v. Montana (Opinion at 8.)

Indeed, by limiting the coal severance tax, Congress would be giving residents of other states the right to dictate the terms and conditions of coal development in Montana. If we in Montana cannot make our own decisions as to how much money is necessary to cover local impacts and how much money is necessary to set aside for future impacts and future problems, we are being exploited just as surely as a colonial power exploits its colony for its own benefit. I call this energy crisis colonialism. It is my hope that we have advanced much beyond this stage in our nation's development.

At the very least, such a limitation would substantially affect the fragile state-federal relationship now existing between our states and our federal government. In order to exist with any sense of sovereignty, a state must have the authority to raise sufficient revenue to take care of its needs. If the general taxing authority is limited by Congress, it would no longer have this authority and sovereignty. It would be a substantial alteration of the existing state-federal relationship.

The precedent in this regard is serious. For example, if Congress can reduce Montana's coal tax to provide cheaper electricity for the rest of the nation, it could reduce severance tax on oil in Texas to produce cheaper gasoline, reduce severance tax on timber in Oregon to produce cheaper wood products, reduce severance tax on taconite in Minnesota to produce cheaper steel products, reduce the single-business tax in Michigan to produce cheaper automobiles, and reduce general sales taxes, general property taxes, and general income taxes in any state. Once Congress has put its foot in the door, it is hard to see where it would stop, and before long there would be no sovereign entity of a state government such as we know it today. It seems that this principal is particularly important right now when Congress is considering block grants and, at the Administrations's request, considering reducing federal assistance to each state by as much as 25%. If Congress reduces existing federal assistance, it certainly would not want to limit the states' ability to levy taxes to cover the necessary deficiencies.

There are many additional arguments in favor of Montana's coal tax and against any bills that have been introduced to limit the authority of Montana to collect such a tax. I am attaching a fact sheet which outlines these arguments and contains some of the facts and figures that support the arguments.

There is one more matter I would like to address. It is my understanding that the Chairman represents the state of Minnesota. It is very strange indeed that someone from Minnesota would be promoting a limitation on severance taxes. It is my understanding that in FY 80, the state of Minnesota collected the following severance taxes on taconite and natural ore:

Royalty Taxes

Taconite, Semi-Taconite & Iron Sulfides - $5,125,000
Iron Ore - $ 924,000

Occupation Taxes

Taconite, Semi-Taconite & Iron Sulfides -$14,539,000
Iron Ore - $2,702,000

Production Taxes

Taconite, Semi-Taconite & Iron Sulfides -$88,484,000

GRAND TOTAL - $111,774,000

Additionally, I understand that an ad valorem property tax is collected at the county level on natural ores (but not taconite). I do not have any figures on how much this would add to the above total.

By contrast, Montana's total coal severance tax collections during the same period were $75,070,423. (In fact, in FY 1981 the revenue dropped to $70,764,375.) No part of this coal tax revenue is allocated directly to property tax relief or to any other relief of the taxes otherwise paid by Montana taxpayers. While I would never suggest that Minnesota should not continue, as it has for years, collecting a substantial tax on taconite and natural ore even though it holds an almost complete monopoly on the source of such minerals in the United States, it does illustrate my point. People who live in glass houses should not throw stones.

You may retort that Minnesota's tax is not as high on a percentage basis. Although I would agree with you that it is not as high as Montana's tax, assuming a percentage is a valid comparison, I submit that the taconite tax on a percentage basis in Minnesota would exceed the maximum rate in the Chairman's Bill S178. Just as 30% is not the true rate of Montana's coal tax because the base is reduced by state, federal and local taxes, so the 12½% proposed in S178 and HR1313 is not a true percentage of invoice price. As a percentage of invoice price, the Montana tax is really 22½% (27.26% when the gross proceeds tax collected at the county level and the resource indemnity trust fund tax is added). As a percentage of true invoice price, the 12½% limitation becomes 9.375%. Although I have not been able to obtain accurate figures for 1980, based on the information received from the Minnesota Department of Revenue, the average invoice price of taconite in 1979 was $32.634 less transportation of $10.02 for a total invoice of $22.614. At the same time, the average production tax on taconite was $1.60 per ton, and the average occupation tax on taconite was 43½¢ per ton. Royalty payments vary considerably according to the nature of land ownership between 25¢ a ton and $2.50 a ton. Assuming royalty at $2.00, the additional royalty tax would be 13.265¢ for a grand total severance tax of $2.16765 per ton of taconite. That amounts to 9.585% of the invoice price or in excess of the limitations set forth in S178.

Therefore, my question to you, Mr. Chairman, is, "Do you also support a limitation of the existing taconite tax in Minnesota?"

Texas is another state which has produced many critics of our coal tax. Attorney General Mark White campaigned and has spoken widely on the issue. Congressman Pickle introduced the very first bill on the subject. They also are in a precarious position because even though the severance tax on oil is only 4.6% and the tax on gas is 7.5%, the state of Texas is receiving over $2.2 billion per year from its severance tax on oil and gas, including the ad valorem tax collected at the county level. This is nearly 30 times the tax collected in the state of Montana on coal.

Professor Bernard Weinstein, of the the University of Texas at Dallas, a person who is very familiar with the whole severance tax question, has made the following very cogent point:

> "For our elected officials and utilities to chastise other energy-producing states for their allegedly excessive severance taxes, in my opinion, is both hypocritical and politically dangerous. It is sheer folly to believe that federal constraints on state energy taxation, if they come, will be limited exclusively to the coal-producing states when the big dollars are accruing to oil and gas-producing states like Texas."

In my opinion, the whole matter should be left alone. Congress should not intrude on the whole question of limiting a state's general taxing authority. It is too dangerous a precedent and certainly could result in very unfair applications.

Thank you for kindly receiving my remarks.

Thomas E. Towe

fu National
Farmers Union

July 16, 1981

The Honorable David Durenberger
Chairman
Intergovernmental Relations Subcommittee
Committee on Governmental Affairs
Room 3306 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

I respectfully request, on behalf of the National Farmers Union, that the enclosed statement regarding "Coal Severance Taxes" be made a part of the record of the hearings of July 15 & 16 which your Subcommittee held on this subject.

We regret that we were not allocated time to personally present our statement to the Subcommittee and respond to any further questions you or the other Members of the Subcommittee may have had.

Sincerely,

Robert J Mullin

Robert J. Mullins
Director of
Legislative Services

Enclosure
RJM:tls

cc: Members of the Intergovernmental Relations Subcommittee
Senator John Melcher
Senator Max Baucus
Senator Malcolm Wallop
Senator Alan K. Simpson

National
Farmers Union

STATEMENT OF

ROBERT J. MULLINS
DIRECTOR OF LEGISLATIVE SERVICES
NATIONAL FARMERS UNION

PRESENTED TO THE

INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

CONCERNING

"COAL SEVERANCE TAXES"

WASHINGTON, D.C.
July 15, 1981

- - - -

Mr. Chairman:

National Farmers Union appreciates the opportunity to provide the Subcommittee with its views on state-imposed severance taxes. Our position on this issue is very clear. Farmers Union fully supports the right of a state to impose severance taxes on natural resources produced within that state. Furthermore, we support the right of a state to decide, through its legislative process, the rate at which such a tax will be levied.

The Board of Directors of the National Farmers Union, meeting in Washington, D.C. on June 1, 1981, adopted the following resolution concerning state severance taxes:

> "National Farmers Union's Board of Directors opposes any measure which would restrict the right of a state to impose a severance tax on natural resources produced within that state. Additionally, we oppose any measure which would limit the severance tax rate which a state may impose."

This issue has been brought to the forefront, of course, by the severance taxes levied by several of the Western states on coal which is produced in those states but the bulk of which is utilized in other states. Critics of the severance taxes levied particularly by the states of Montana and Wyoming argue that the taxes are burdensome on electric consumers in other states and retard the national goal of increased domestic coal production. We maintain that the facts do not justify such arguments. Other critics of the taxes, notably the electric companies, challenged the constitutionality of the taxes. The United States Supreme Court has ruled in COMMONWEALTH EDISON, ET AL v. MONTANA, ET AL that the Montana severance tax does not violate the Commerce Clause of the United States Constitution. Furthermore, the Court held that the tax does not violate the Supremacy Clause of the Constitution. (Decision attached.)

Critics of the severance taxes on western coal charge that the western "producing" states are "gouging" the "consuming" states. This is not so. The severance tax that Montana imposes on strip-mined coal averages less than one percent of the total annual cost of an electrical consumer's bill in states where Montana coal is used as a boiler fuel. In absolute dollar amounts, the average cost to the consumer of the Montana severance tax is $2.54 per year. (See attached.) The major cost to electrical consumers comes from the transportation costs associated with moving western coal to the East and South. As much as sixty percent of the total cost of the coal can be attributed to transportation.

Additionally, the very states who use electricity generated by western coal increase the cost of electricity to their own citizens through state sales taxes on electricity. Illinois charges an additional 5% through its Public Utility Tax; Minnesota imposes a 4% sales tax; sample sales tax rates on electricity in other states include: Iowa 3%, Indiana 4%, Wisconsin 4%, Michigan 4%, and Nebraska 3% with some municipalities charging an additional 1 - 2%. Texas imposes a sales tax on business use of electricity which generates approximately $100 million.

As an organization representing thousands of farm and ranch families in the western regions where coal is produced, we are concerned that they and the other citizens of those states do not bear the total economic, social and environmental costs of producing coal so that others may have electricity. Fifty percent of the Montana tax goes to a Constitutional Trust Fund dedicated to helping relieve future social, environmental and economic burdens associated with immediate coal production. Citizens of these mineral and coal producing states have learned their lesson by the past "rape, ruin and run" development of other natural resources. When these resources are gone, they are gone forever, and the state is left with a greatly diminished economic base.

With an Administration in office that is seeking to return more and more of the administration and funding of social, health, educational and environmental programs back to the states, where are they to receive the money to fund those programs, particularly those states with otherwise limited business or manufacturing bases? The Court did rule in COMMONWEALTH EDISON that "the appropriate level or rate of taxation is essentially a matter for legislative, not judicial, resolution." We urge, however, the Congress to tread lightly in this area. There is a fundamental wrong in having the Congress restrict the right of a state to determine its tax policy.

We would suggest that critics of natural resource severance taxes examine these taxes in perspective. A recent study by the National Farmers Union shows that, as of April 1980, twenty four states imposed a tax on natural resources produced within those states (study attached).

The four basic types of taxation utilized are Ad Valorem Taxes, Severance Taxes, the Gross Production Tax, and the Net Production Tax.

Will critics of the Montana severance tax, which raised approximately $74.2 million in revenue during 1980 carry their objections one step further and maintain that the $2.1 BILLION raised by the State of Texas from oil and gas is excessive or that Michigan's $60 million from oil and gas production is adversely affecting consumers?

The Farmers Union believes that the Congress does have a responsibility to act. But that responsibility is not to limit the right of a state to impose severance taxes or the rate thereof. The responsibility that the Congress has is to develop a comprehensive rational National Energy Policy.

The elements of such an energy program include:

a. Reducing the control of giant corporations over the sources, production and distribution of energy;

b. Equitable distribution and efficient development of energy to assure adequate production of food and fiber;

c. A pricing policy which will prevent economic hardship;

d. Balancing energy needs with the necessity to maintain a safe and ever-renewing environment; and,

e. A massive program to develop renewable sources of energy to reduce our dependence on fossil fuels, including economic assistance for family farmers to make agriculture more self-sufficient through increased application of alternative forms of energy.

ATTACHMENT I

(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

COMMONWEALTH EDISON CO. ET AL. *v.* MONTANA ET AL.

APPEAL FROM THE SUPREME COURT OF MONTANA

No. 80-581. Argued March 30, 1981—Decided July 2, 1981

Montana imposes a severance tax on each ton of coal mined in the State, including coal mined on federal land. The tax is levied at varying rates depending on the value, energy content, and method of extraction of the coal, and may equal, at a maximum, 30% of the "contract sales price." Appellants, certain Montana coal producers and 11 of their out-of-state utility company customers, sought refunds, in a Montana state court, of severance taxes paid under protest and declaratory and injunctive relief, contending that the tax was invalid under the Commerce and Supremacy Clauses of the United States Constitution. Without receiving any evidence, the trial court upheld the tax, and the Montana Supreme Court affirmed.

Held:

1. The Montana severance tax does not violate the Commerce Clause. Pp. 3-18.

(a) A state severance tax is not immunized from Commerce Clause scrutiny by a claim that the tax is imposed on goods prior to their entry into the stream of interstate commerce. Any contrary statements in *Heisler* v. *Thomas Colliery Co.*, 260 U. S. 245, and its progeny are disapproved. The Montana tax must be evaluated under the test set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274, 279, whereby a state tax does not offend the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the State." Pp. 3-6.

(b) Montana's tax comports with the requirements of the *Complete Auto Transit* test. The tax is not invalid under the third prong of the test on the alleged ground that it discriminates against interstate commerce because 90% of Montana coal is shipped to other States under contracts that shift the tax burden primarily to non-Montana utility companies and thus to citizens of other States. There is no real discrimination since the tax is computed at the same rate regardless of the final destination of the coal and the tax burden is borne according to the amount of coal consumed, not according to any distinction between in-state and out-of-state consumers. Nor is there any merit to appellants' contention that they are entitled to an opportunity to prove that the tax is not "fairly related to the services provided by the State" by showing that the *amount* of the taxes collected exceeds the *value* of the services provided to the coal mining industry. The fourth prong of the *Complete Auto Transit* test requires only that the *measure* of the tax be reasonably related to the extent of the taxpayer's contact with the State, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a just share of the state tax burden. Because it is measured as a percentage of the value of the coal taken, the Montana tax, a general revenue tax, is in proper proportion to appellants' activities within the State and, therefore, to their enjoyment of the opportunities and protection which the State has afforded in connection with those activities, such as police and fire protection, the benefit of a trained work force, and the advantages of a civilized society. ~~The appropriate level or rate of taxation is essentially a matter for legislative, not judicial, resolution.~~ Pp. 6–18.

2. Nor does Montana's tax violate the Supremacy Clause. Pp. 18–25.

(a) The tax is not invalid as being inconsistent with the Mineral Lands Leasing Act of 1920, as amended. Even assuming that the tax may reduce royalty payments to the Federal Government under leases executed in Montana, this fact alone does not demonstrate that the tax is inconsistent with the Act. Indeed, in § 32 of the Act, Congress expressly authorized the States to impose severance taxes on federal lessees without imposing any limits on the amount of such taxes. And there is nothing in the language or legislative history of the Act or its amendments to support appellants' assertion that Congress intended to maximize and capture through royalties *all* "economic rents" (the difference between the cost of production and the market price of the coal) from the mining of federal coal, and then to divide the proceeds with the State in accordance with the statutory formula. The history speaks in terms of securing a "fair return to the public" and if, as was held in *Mid-Northern Oil Co.* v. *Walker*, 268 U. S. 45, the States, under § 32, may levy and collect taxes as though the Federal Government were not concerned, the manner in which the Federal Government collects receipts from its lessees and then shares them with the States has no bearing on the validity of a state tax. Pp. 18–21.

(b) The tax is not unconstitutional on the alleged ground that it

Syllabus

frustrates national energy policies, reflected in several federal statutes, encouraging production and use of coal, and appellants are not entitled to a hearing to explore the contours of these national policies and to adduce evidence supporting their claim. General statements in federal statutes reciting the objective of encouraging the use of coal do not demonstrate a congressional intent to pre-empt all state legislation that may have an adverse impact on the use of coal. Nor is Montana's tax pre-empted by the Powerplant and Industrial Fuel Use Act of 1978. Section 601 (a)(2) of that Act clearly contemplates the continued existence, not the pre-emption, of state severance taxes on coal. Furthermore, the legislative history of that section reveals that Congress enacted the provision with Montana's tax specifically in mind. Pp. 21–25.

— Mont. —, 615 P. 2d 847, affirmed.

MARSHALL, J., delivered the opinion of the Court in which BURGER, C. J., and BRENNAN, STEWART, WHITE, and REHNQUIST, JJ., joined. WHITE, J., filed a concurring opinion. BLACKMUN, J., filed a dissenting opinion, in which POWELL and STEVENS, JJ., joined.

ATTACHMENT II

SUMMARY OF THE COST TO THE CONSUMER OF THE MONTANA SEVERANCE TAX
1979

tility	Quantity[1] (1000 ton)	Cost of Montana Coal Dlvrd[1]	F.O.B.[2]	C.S.P.[3]	Sev Tax per ton[4]	Sev Tax paid[5] X	Readt'l % of Total Kwh Sales[5] ÷	Avg # of Readt'l Customers =	Annual Cost per Read'tl Customer
ommonwealth Edison	4,185.2	$33.62	$15.83	$11.28	$3.38	$14,146,000	27.7	2,676,826	$1.46
nterstate Power	247.4	24.46	7.97	5.49	1.65	408,000	20.8	108,855	0.78
etroit Edison	2,500.0	26.17	13.36	9.45	2.84	7,100,000	27.8	1,603,624	1.23
innesota Power & Light	2,783.6	17.68	7.84	5.50	1.65	4,600,000	8.0	91,422	4.03
orthern States Power	8,348.2	16.51	5.50	3.73	1.12	9,350,000	24.4	949,499	2.40
ontana Power Company	1,942.5	5.75	5.48	3.72	1.12	2,168,000	22.5	187,701	2.59
ower Colorado River Auth.	804.5	35.55	6.83	4.70	1.41	1,134,000	4.6	16,566	3.15
isconsin Power & Light	2,064.6	15.12	6.44	4.41	1.32	2,725,000	38.8	259,550	4.07
entral Illinois Light	686.9	27.89	11.57	8.08	2.42	1,662,000	31.3	163,455	3.18

[1] Source: Form 423

[2] F.O.B., freight on board, delivered cost less transportation charges.

[3] C.S.P., contract sales price, F.O.B.=CSP + .3CSP^{a} + .005CSP^{b} + (.45)(CSP)(Mill levy)^{c} + \$0.35^{d} + .02 F.O.B.^{e}

[4] 30 percent of CSP.

[5] Source: Annual Report, S.E.C. Form 10-K, or Uniform Statistic Report.

[a] Montana Severance Tax.

[b] Resource Indemnity Trust Tax.

[c] Gross proceeds (local ad valorem property tax).

[d] Federal Abandoned Mine Reclamation Fee.

[e] Federal Black Lung Tax, has an upper limit of $0.25 per ton.

5/28/80

ATTACHMENT III

MINERAL TAXATION

April 1980

There are basically four kinds of mineral taxation that states enact to receive revenue from the mineral operations within the state.

a. Ad Valorem Tax
This was the first kind of tax imposed on mineral property. The property is assessed according to state procedure. Then the local milleage rate is applied to the assessed value.

b. Severence Tax (true severence tax)
Severence tax is levied at a set amount per unit amount produced. It is levied according to a rate schedule based on the amount the mine produces.

c. Gross Production Tax
Taxes are levied on a measure of the dollar value of the product extracted from the mine.

d. Net Production Tax
Companies are allowed to deduct some expenses from gross revenues in order to reach the definition of net taxable production.

Most states use a combination of taxes for various minerals. Varying rate structures for different minerals can be found in nearly every state. Severence tax, gross production tax, and net production tax are relatively new taxes and are being used more frequently as mineral taxation laws change.

During the 1977-78 legislative session 14 states modified mineral tax systems. It is expected more states will begin to re-examine existing mineral taxation programs as energy prices continue to rise. There is an increase in mineral consumption which is creating a demand for more mineral production. The west, more than any other region, is feeling a heavy pressure demand for the increased exploration and production of coal.

The western states and agriculturally based economies will undergo the largest structural change due to energy development. Small towns will suffer the greatest impact with major changes in social and economic structure.

The rapid change in the amount of services needed in impact communities puts immediate pressure on tax bills of all residents affected by mineral development.

Agricultural land comprises most of the tax base in mineral development areas. The quantity and quality of local government services as the tax base changes will have great impact on local farmers and ranchers.

The major problem with mineral development is called a "front-end problem." This is new services needed in an impact community because of increased amount of people brought in to work in the mineral development and the lack of ability to finance these services until the mine is in full production. (In coal development that time period is averaging 3 years.)

The following is a table briefly explaining mineral taxation programs in 25 states having such legislation.

Montana is considered to have the most comprehensive mineral taxation program in the states. There is more detail on that program attached to the table. Because Montana is heavily affected by coal development, other coal-producing states are looking at this legislation as a possible model.

STATE	Alabama	Alaska	Arizona	Arkansas	California	Colorado
Amount of money generated by mineral taxes - 1977 figures	$13.7 million	$23 million	Unavailable	$10.4 million (1% of total state revenue)	$2.3 million (0.07% - total state revenue)	$2.3 million (0.2% of total state revenue)
Kind of tax (predominate source of mineral tax)	Oil/natural gas - gross production Severance on other minerals	oil - gross production	Ad valorem taxes Mineral privilege tax	Severence in addition to general property tax.	oil/gas production tax	Severance tax credit from ad valorem available on most minerals
Rate structure (brief overview)	Oil, natural gas, coal, iron ore - 4% gross value. 3¢/Long ton - coal 13.5¢/Short ton - coal	oil - 12.25% of value at production or 60¢ barrel old crude — 80¢ barrel other crude. (Law establishes an economic limit by a complex formula.)	1.5% of gross proceeds levied on every person in mining or producing minerals for sale. 1% of gross receipts - mineral privilege tax Land is assessed at 60% of its mineral market value.	2¢/short ton of coal 3¢/1,000 cubic feet of natural gas	Tax levied on number of barrels of oil and thousands of cubic feet of natural gas. Rate determined annually by California Department of Conservation.	Coal - 60¢ ton after first 8,000 tons. Oil shale - 4% of gross proceeds. Rate schedule for oil and natural gas is on % of gross income. All mines are subject to ad valorem taxes if no credits available.
Where does money go?	50% to state 50% to counties and municipalities - part of this allocated to schools.		General fund counties incorporated cities Department of Economic Security	Most revenue goes back to local governments. General revenue fund - 3%		Severance Tax trust fund Income from investment will go to general fund. Distribution of 85% of the money back to local communities - remainder goes to general fund.

STATE	Florida	Idaho	Kentucky	Louisiana	Michigan	Minnesota
Amount of money generated by mineral taxes - 1977 figures	$4.7 million (1.6% total state revenues)		$11.3 million	$495 million (29% of total state revenue)	$9 million (0.2% state revenue)	$59 million (2.4% of state revenues)
Kind of tax (predominate source of mineral tax)	Severance - solid minerals gross production - oil and natural gas	2% of net value of ore mined	Severance	Severance	Production tax	Occupation tax Royalty tax
Rate Structure (brief overview)	Credit available for ad valorem taxes. If reclamation or restoration is shown credit on this also.	Various formulas available to compute rate for net value of ore.	Coal - 4.5% of gross value Oil - 0.5% on market value	Coal - 10¢/short ton Oil - 12.5% of value at time of severance	2% of gross value of oil	$125/ton of merchantable iron ore. 15% royalty tax to explore for ore. 15% occupation tax on and iron sulfides. 15.5% other iron ores Tax credits to encourage utilization of lower grade ore.
Where does money go?	Land reclamation Trust fund State feneral fund receives majority of money. If impact area institutes a reclamation project, qualify for more money.	General Fund	Coal producing County development fund	1/3 - general fund 1/3 - to parish in which mine is. 1/3 - severance tax fund.		

STATE	Mississippi	Montana	New Mexico	North Dakota	Ohio	Oklahoma
Amount of money generated by mineral taxes - 1977 figures	$23.4 million (2.4% of state revenues)	See attached expanation of Montana law.	$102 million (17% of state tax revenues)	$15.4 million (5.2% of state revenues)	$4 million	$191 million (16.7% of total state revenues)
Kind of tax (predominate source of mineral tax)	Severance tax		Severance tax	Gross production	Severance tax	Production taxes
Rate structure (brief overview)	Oil - 6¢ barrel or 6% of value, whichever is greater Natural gas - 6% of value or 3 mills cubic foot whichever is greater All gas is exempt from ad valorem taxes.		Steam coal - 0.47¢ per ton. Oil - 0.45¢ per barrel Gas - 0.05¢ on each 1,000 cubic feet. Complicated rate structure for other minerals. Mineral property is also subject to ad valorem tax.	Oil and gas - 5% of gross value at well. Coal - 65¢ ton and 1¢ ton for each point the wholesale price index increases from June 77. 2.5% of gross receipts on coal coversion facilities.	4¢ per ton of coal 3¢ per barrel of oil 1¢ per 1,000 cubic feet of natural gas.	.75% on gross value of asphalt and some ores. 7% on gross value of petroleum and natural gas. Oil excise tax of 25¢ per barrel and 0.05¢ per 1,000 cubic feet of gas.
Where does money go?	Most money goes to state. Very little returned to impact areas.			Coal Development Fund General fund Counties - each gets a varying percentage of each $200,000 generated.	Goes back to reclamation projects.	Varying percentages from different minerals goes to: General fund Teachers Retirement Fund County Highway Fund School Districts Oklahoma Tax Commission Fund

STATE	South Dakota	Tennessee	Texas	Utah	West Virginia	Wisconsin
Amount of money generated by mineral taxes - 1977 figures	$500,000		$905 million (19% of state revenue)	$8.9 million (1.5% of state revenue)		$184,930
Kind of tax (predominate source of mineral tax)	Net production Severance on oil and natural gas.	Production tax Severance	Severance tax Occupation tax	Occupation tax	Gross production	Comprehensive net progress tax
Rate structure (brief overview)	4% of profits from minerals or mineral products. Exempts anyone mining less than $100,000. Severance tax on oil and natural gas is 3% of gross value at well.	Coal - 20¢ per ton severance Oil - 5¢ per 50 gallon barrel - production Gas- 5% on sale price	Occupation - gas - 7.5% market value oil - 4.6% gross value sulfur - $1.03 long ton	Mining occupation - 1% of gross amount oil and gas - 2% of value	Series of annual taxes for the privilege of mining in the state. Coal - 3.5% gross production Oil - 4.34% gross production Natural gas - 8.63% of gross production Additional 0.35% severance on coal.	Progressive rate schedule for all metallic mineral mining
Where does money go?		All revenue returned to counties (less 1% administrative cost)	School funds (Omnibus tax) (Clearance Fund)	General fund Special allocation for facilities needed as a result of the development of natural resources.	75% of the tax dollar goes back to impact areas.	General Fund - 50% Investment and local impact fund - 50%

STATE	Wyoming					
Amount of money generated by mineral taxes - 1977 figures	$4.7 million (20% of state revenues)					
Kind of tax (predominate source of mineral tax)	Severance - coal Production - oil and gas					
Rate structure (brief overview)	Oil and gas - value at the well not to exceed 0.4 mills per dollar of value Mining excise - 2% of gross product Coal severance - 0.5%					
Where does money go?	Wyoming Community Development Authority Also to the Farm Loan Board					

Table 2. Montana Severance Taxes

Coal Severance Tax

Heating Quality (BTU/pound)	Surface Mining	Underground Mining
Under 7,000	$0.12 or 20% of value	$0.05 or 3% of value
7,000-8,000	$0.22 or 30% of value	$0.08 or 4% of value
8,000-9,000	$0.34 or 30% of value	$0.10 or 4% of value
Over 9,000	$0.40 or 30% of value	$0.12 or 4% of value

Oil and Gas Severance Tax

Oil

Up to $6,000 gross value: 2.1% of gross value

Above $6,000 gross value: 2.65% of gross value

Gas

2.65% of gross value

Resource Indemnity Trust Tax (All Minerals)

$25 plus 0.5% of gross value of product if in excess of $5,000

Metalliferous Mines License Tax (Metallic Minerals)

Gross Value:

First $100,000	0.15 of 1% of gross value
$100,000 to $200,000	0.575 of 1% of gross value
$250,000 to $400,000	0.86 of 1% of gross value
$400,000 to $500,000	1.15%
Over $500,000	1.438%

Micaceous Minerals License Tax

Vermiculite, perlite, kerrite, maconite, or other micaceous minerals	$0.05/ton

Cement License Tax

Cement	$0.22/ton
Cement, plaster, gypsum, or gypsum products	$0.05/ton

MONTANA

General Information

COAL BOARD
DEPARTMENT OF COMMUNITY AFFAIRS
and the
LOCAL IMPACT ASSISTANCE
GRANT PROGRAM

INTENT

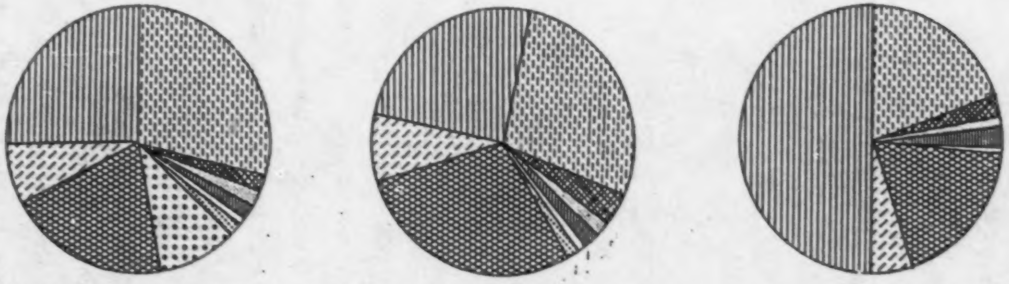
The intent of SB 87 and the Local Impact Fund is to aid units of local government in providing governmental services and facilities needed, that they are unable to adequately provide as a direct result of the coal development.

A unit of local government is defined as counties, incorporated cities and town, school districts, and special improvement districts.

SOURCE OF FUNDING

Senate Bill 87 (1975 Session) defined the allocation of the 30% Coal Severance Tax that was established by Senate Bill 13 of the 1975 session. An initiative measure, which received an affirmative vote in the 1976 general election, called for setting aside part of the proceeds of the coal severance tax as an inviolable "permanent" fund. Senate Bill 44 (1977 Session) set the portion which will be placed in this fund as well as adjusted the percentage of revenue flowing to each of the other funds. The allocations by percentages are illustrated on the following chart.

		7/1/77-6/30/79	7/1/79-12/31/79	1/1/80-
▥	Coal Tax Trust Fund	25%	25%	50%
▨	School Equalization	7.5%	7.5%	5%
▩	Local Impact & Education Trust	19.875%	28.125%	18.75%
⁘	Coal Area Highways	9.75%	---	---
▦	Counties	1.5%	1.5%	---
○	County Land Planning	.75%	.75%	.5%
●	Alternative Energy Research	1.875%	1.875%	2.5%
◍	Renewable Resource Development	1.875%	1.875%	1.25%
▣	Parks Acquisition	1.875%	3.75%	2.5%
▒	General Fund	30%	29.625%	19.5%



July 1, 1977-June 30, 1979

July 1, 1979-December 31, 1979

After December 31, 1979

ALLOCATION OF COAL SEVERANCE TAX

The Coal Board has the administrative responsibility for two actual funds, the Education Trust Fund, and the Local Impact Fund. However, the Educational Trust Fund is an inviolate fund, set aside for future educational needs, and all monies are automatically invested by the Investment Division, Department of Administration, as they are received. Interest earned from both funds are earmarked for state educational equalization aid and to the institutions of higher learning in the state.

FUNDS AVAILABLE FOR LOCAL IMPACT

During the 1975/76 fiscal year, the Coal Board received $3,855,567.21 from the severance tax. Estimated future receipts for the 1976/77 fiscal year and the next biennium are:

Fiscal 76/77	$ 6.710 million
Fiscal 77/78	$ 6.945 million
Fiscal 78/79	$ 8.644 million

These estimates are based on the legislation as it is in effect today. Actual receipts are a result of coal mining volume, and the price of coal extracted and prepared for shipment excluding that amount charged by the seller for taxes. Company reports indicate this price ranged from $3.27 to $5.26 per ton for the first quarter of 1977.

PROJECT AND PROGRAM ELIGIBILITY

Because the intent of SB 87 is to provide adequate government services and facilities that are needed by impact communities, a wide range of programs and projects are eligible for funding under this legislation. Applications have been made for:

A. Construction Programs

- education buildings
- sewage and water system improvements
- jail & fire department buildings

B. Equipment

- street maintenance equipment
- sewage & water system maintenance equipment
- education equipment & furniture
- law enforcement vehicles
- fire protection vehicles

C. Services

- clerical services
- health services
- planning services
- law & order services

GRANT PROCESS

A. Pre-Application

A unit of local government normally requests information from the Coal Board, Department of Community Affairs. The unit completes a pre-application and then submits it to the Coal Board office. Upon receipt, the pre-application is first checked on eligibility i.e., (1) that it is an appropriate unit of local government making the application, (2) and is from an area where there is coal impact.

This pre-application is a narrative sort of form describing the applicant, the project, its relationship to coal development, and how this project will solve the problem. It is distributed to various divisions for review. Coal Board Staff, Planning Division and any other divisions that would have knowledge or expertise in the project area would be asked to review. Examples: airports - Aeronautics, sewer & water - Health Environmental Services, schools - Public Instruction. When these reviews are completed, staff meets and reaches an agreement on a recommendation, and that recommendation is then made to the Board at their next meeting.

There are many different guidelines that are taken into consideration by staff before these recommendations are made. Each individual project is judged on its own merits, but some of the common areas are: (1) need, (2) severity of impact, (3) degree of local effort, (4) population changes, (5) comparison of like cities, counties, or school districts, (6) availability of funds.

The Board meets monthly or bi-monthly, as workload demands, to consider pre-applications and full applications. These meetings are held the second Thursday and Friday of the month. Applicants have the opportunity to address the Board regarding the pre-applications at these meetings. After the Board has considered the staff recommendation and discussed the pre-application with any representatives of the applicant who may be present, it either denies the proposal, asks for more information or calls for a full application.

B. Full Application

The full application requests additional information on the project, including project cost estimates, citizen participation, and budget information. When received by staff, it goes through the same review process as the pre-application. Again, when the reviews are complete, staff meets and determines its recommendation to the Board.

The procedure for Board consideration of the full application is the same as it is for the pre-application. Board actions on full applications have included denial, partial funding, full funding, or tabling until a later date.

c. Contracts

When a project has been funded, contracts are drawn for the use of funds, the amount of the grant, the method of payment, documentation requirements, and the date of completion of the project. The contracts provide for completion reports and audits.

OVERVIEW

The Coal Board is a very public board, holding the majority of its meetings in the impacted areas. This has allowed the people affected by coal development access to the Board, and has provided Board members with a greater perspective of the problems being faced. The Board has personally toured each of the major impacted areas on at least one occasion and sometimes more. Future meetings are being scheduled in the impact areas so the Board may then inspect the projects they have already funded to see the results of their efforts.

During the 1975 legislative session, a Legislative Oversight Committee was created to observe, inspect, comment and review the actions of all Departments who administer any portion of the Coal Severance Tax. The Committee presented a favorable report to the 1977 legislative session realtive to the actions the Board has taken, and with the way the entire program is being run.

Grant awards to impact communities exceeded $13 million during the 1975/77 biennium. Major construction programs, such as schools and sewer and water systems, account for the major portion of this funding. In addition essential equipment and services have been provided to the communities through local impact assistance grants.

The vast majority of citizens and officials are very satisfied with the program.

[Reprinted from Planning, the magazine of the American Planning Association, January 1979]

COMMUNITIES AND ENERGY DEVELOPERS CAN WORK TOGETHER

(By Malka L. Pattison and Philip A. Marcus)

Energy development in recent years has led to new demands on communities as developers have sought sites for power plants, attempted to open coal mines, or locate onshore facilities to support offshore oil and gas operations. But there is a changing attitude among many communities and energy developers as to who should bear the costs of these developments and their attendant impacts.

In the past, communities usually have either yielded passively to the impacts of development booms and busts or turned to state and federal government for impact assistance to alleviate these growth-related problems. ("Here's what should be done about the energy-boom towns," March 1977.) Now, however, many communities facing energy developments are turning to a new solution: They are bringing in the developers to help identify and forestall or alleviate many impacts.

This trend may be accelerated by the Energy Impact Assistance Bill, which died in the last Congress but is expected to be reintroduced in the Ninety-sixth Congress. A Congressional Budget Office study of the bill last year revealed that the proposed legislation could overlap with aid to communities that is provided in seven other pieces of federal legislation. While the energy impact assistance bill would have provided federal grant and loan assistance to energy-impacted communities, it also would have made available direct contributions of funds or services by energy developers to assist these communities.

Although energy developers were disenchanted with provisions of the bill, they do realize that their traditional role is changing. More and more energy companies and utilities understand that they can achieve their goals of supplying energy and maximizing corporate profits better if they provide loans, tax prepayments, or grants to localities. For the developer, impact assistance can result in faster permit issuance and license renewals as well as improved public relations. David Myhra, commissioned by the White House Task Force on Impact Assistance to make an analysis of companies providing socioeconomic assistance, has estimated that 24 energy companies are involved in impact assistance programs across the United States.

"Impact assistance programs that attempt to mitigate the negative effects of rapid energy development should be looked on as part of the cost of the project," says Richard Swisher of the Tennessee Valley Authority's Socioeconomic Impact Mitigation Program. "Making an early commitment to work with an impacted community is a significant part of our program. Right now we have coordinators at three project sites who work directly with local communities and other TVA staff to develop a site-specific program of assistance for the affected areas."

At first glance, the goals of developers and communities seem to be different. Developers want to maximize profits and eliminate costly delays, while communities strive to maintain or enhance their quality of life. But there is some overlap between these goals that provides an opportunity for cooperation and mutual benefit. Impact assistance that helps maintain or enhance a community's quality of life also can help the developer in recruiting and retaining employees. In addition, it can help avoid delays in construction that otherwise could occur while the community either seeks state or federal assistance or intervenes against project authorization or completion.

While direct discussions between local officials and energy developers for impact assistance mean an increased local role, they also mean new responsibilities. To prepare themselves for these responsibilities, local officials first should familiarize themselves with the probable effects of rapid growth in their community or area. They can do much to ensure that a comprehensive impact assessment is made that identifies the community's needs and translates them into dollars or programs. They also can provide the energy developer with a specific proposal for impact assistance.

Five case studies illustrate how successful negotiations can be conducted between community and industry representatives for impact assistance:

As part of a contract rezoning agreement, the Puget Sound Power and Light Company agreed to prepay some of its taxes to Skagit County, Washington, where it proposed building a two-unit nuclear generating plant. The tax prepayment is to finance additional schools and law enforcement necessitated by the influx of construction workers and their families.

To obtain a construction permit from the Wyoming Industrial Siting Commission, the Basin Electric Power Cooperative agreed to provide adequate housing and facilities for the temporary and permanent work force expected at its coal-fired electric generating plant near Wheatland. Basin Electric also agreed to comply with an imposed ceiling on the number of construction workers employed. In addition, Basin Electric granted $18,000 to Wheatland to help the community apply for federal funds to establish a planning department.

Under a contract agreement for its proposed offshore oil platform fabrication yard in Northampton County, Virginia, the Brown and Root Company agreed to purchase water and sewer services from the town of Cape Charles. Furthermore, the company agreed to contribute $100,000 in matching funds to construct an access highway to its proposed site and will conduct local job training programs.

TVA entered into an agreement with Hartsville, Tennessee, officials during construction of its multiunit nuclear power plant. To help mitigate the socio-economic impact of the construction of the facility, TVA is providing numerous kinds of impact assistance, including police and medical services, school and sewer construction, and assistance in developing a mobile home park. To reduce the number of in-migrants, TVA is providing vans to transport workers to and from the construction site.

Washington Public Power Supply System, under provisions of the state siting law, has agreed to provide the Gray's Harbor County cities affected by the construction of its nuclear power plant with additional police, sewage and water services, dump trucks, street work, and schools. The utility also has supplied the state and county with funds for road and highway work.

Seven crucial considerations are evident from these examples that point out how communities can proceed in their discussions with energy developers.

One of them is community leverage. The community's power to withhold licenses and permits for the construction and operation of energy-related facilities can be a key ingredient in siting decisions. Existing planning and zoning controls may ensure the best use of these powers. Skagit County's success is due largely to its reliance on an existing zoning code. Where little or no zoning exists, or where zoning is unenforced, developers have little reason to acknowledge that their actions can create any impacts requiring mitigation.

State facility-siting regulations are powerful tools for backing communities in the negotiation process. They are particularly important when a project is outside the boundaries of the community to be impacted. Wyoming's Industrial Siting Law requires energy companies with projects valued at over $55 million to agree to mitigate all adverse socioeconomic impacts before construction permits can be issued. This requirement gave both Wheatland and Platte County an opportunity to bargain with Basin Electric for assistance payments. In Washington, both Skagit County and the communities of Gary's Harbor County acted under their state's facility-siting law, which authorizes utilities to make payments to localities for mitigating the impacts of rapid development.

Local leverage also can be gained by bringing federal forces into play if the facility is federally controlled. Mayor James Donoho of Hartsville, Tennessee, appeared before the Atomic Safety and Licensing Board in 1974 as an intervenor, protesting that TVA had significantly underestimated the socioeconomic impacts associated with the construction of a large generating facility four miles from his small town. Donoho claimed that within 18 months after the beginning of construction, the town's population would increase by 25 percent. The board attached conditions to its approval of the TVA's construction permit, requiring adequate assistance for public services and facilities in the five-county impact area.

The ability of a site to meet industry's requirements can give the community bargaining leverage. The Northampton County, Virginia, site is suited particularly well for the land requirements of the proposed platform fabrication yard. Consequently, Brown and Root was willing to enter into negotiations with the community. Extractive industries (oil, gas, or coal) can be committed even more closely to a specific location once the existence of the resource is proven. The community should assess industry's siting flexibility.

Early contact between the community and the energy developer is another consideration. It can lead to an understanding of mutual interests and provides notice that the community will be an active participant in identifying needs and developing an impact mitigation strategy. "The quicker you can get the developer to the negotiating table, the better off you are," says Keith Bull, Northampton county administrator. "By establishing your posture toward impact assistance as rapidly as possible, you can avoid the problems of delay or the buildup of political pressures to accept the project as it is."

On the other side of the coin, early notification from developers of potential construction is of critical importance to successful negotiations. Most communities that have experienced successful negotiations have received two to three years' advance notice from the developers before construction. Ideally, the notice should include information on the magnitude, timing, and duration of labor-force buildup. Of course, early notification allows communities time to prepare or update comprehensive plans, revise capital improvements programs, and design special planning programs that require state or federal funding.

An acceptable impact assessment and needs identification study also is vital to successful negotiations. Conflicts between the community and the developer during negotiations can be avoided or reduced if an impact study acceptable to both parties is performed soon after the company's interest is made known. The study allows both parties to negotiate from a common point in identifying the impacts and the extent of the company's responsibility. The impact assessment also serves to translate the community's needs into dollars or programs. Local officials must have such estimates before they can approach developers for impact assistance. Developers are most likely to react positively to impact assistance requests if the community identifies the specific assistance required. Most of the past successful negotiations between communities and energy developers were based on impact studies that were credible to both parties.

The funds or expertise required to perform impact studies can come from either the developer or the community. Basin Electric conducted a detailed social impact assessment for its plant in Wheatland, Wyoming, that was reviewed and accepted by the community. In Skagit County, the Puget Sound Power and Light Company originally prepared the impact study, but a joint impact assessment was published after review by the county.

Recognition of how developers benefit from impact assistance is still another important consideration in negotiations between developers and communities. A company is more likely to assist a community if it will eliminate costly delays before and during the facility's actual construction. Most impact mitigation costs are lower than the soaring costs triggered by delays. While impact mitigation can involve expenditure of thousands or even millions of dollars, delays can be even more costly. Developers benefit when communities cooperate by streamlining the permitting and approval process. Rather than wait for confrontations, the developer can benefit by cooperating with the community to help solve social and economic problems. In many instances, such cooperation will enable a project to proceed at a faster rate than would otherwise be possible.

Energy companies need to recruit and retain a productive labor force. The productivity and labor benefits resulting from making the community a desirable place to live and work can be a strong motivation behind corporate efforts to protect environmental quality and manage the growth effects stimulated by the facilities. An important motivation for providing temporary housing and funds for community services is to maintain high productivity and low absenteeism among the labor force.

For example, Basin Electric forecasts show the company saving millions of dollars because of increased productivity, which has pushed construction ahead of schedule. "We recently received a contractor's bid that was several million dollars less than we expected," says Robert Valeu, impact coordinator for the Basin Electric Cooperative. "The contractor explained that, because our impact alleviation program would provide adequate housing and facilities for their workers and families, they expected to hold onto their work force and complete the project on time."

Public image is important to energy companies. "An essential point in our negotiations was that the power system recognized that it must become part of the community," says Patrick Dugan of the Gray's Harbor Regional Planning Commission. Interviews with energy company officials reveal that they are aware that adverse reactions to one of their developments can seriously affect the acceptance of future development proposals in other communities.

Basin Electric established two advisory boards for its plant near Wheatland. The first, the Platte County Task Force, is an informal body made up of department heads, citizens, and community leaders. It serves as a sounding board to help Basin Electric identify key problems. A second, formal board, composed of the Wheatland city council, the county commissioners, and the planning and zoning commission, handles direct negotiations with the company. Specific agreements for impact assistance are made by the company and the affected jurisdictions.

"Our monthly task force meetings have tied all the entities together," says James Dunham, town clerk of Wheatland. "This helped unify the city and county and the various agencies. I am primarily concerned with utilities like water, sewers, and electricity, but through this task force I got a good appreciation for the needs of other groups like the school board."

The advisory board concept also has worked well within a single county. Skagit County used a working committee composed of the chief of the planning commission, the prosecuting attorney, a utility representative, and an environmental intervenor to arrive at a mutually acceptable contract zoning proposal that could be brought before the county board at the rezoning hearing.

In Gray's Harbor, Washington, the regional planning commission established a steering committee composed of county and city representatives. A steering committee member negotiated directly with the utility, the Washington Public Power Supply System. Specific assistance contracts were made between each impacted city and the utility.

A final but necessary ingredient in the negotiation process is a monitoring program to ensure a flexible response. The program should be designed as an integral part of the impact assessment and assistance package. Once a project is under way, there is a real need to monitor changing levels of population, workers, and demand on the community's facilities and services to check the validity of the original projections. Monitoring programs also should evaluate the effectiveness of the mitigation measures.

Basin Electric agreed to develop a socioeconomic impact monitoring program in Wheatland. The monitoring program includes provisions to identify unanticipated impacts, evaluate the effectiveness of mitigation programs, and provide information and analysis on social impact assessment strategies. A local monitoring board conducts monthly meetings to assess changes and adjust community response.

Although negotiation may be a valuable tool for siting energy developments, it may not be an appropriate form of conflict resolution in every circumstance. Bargaining between the community and industry over impact assistance may be most successful when concern over energy facility siting stems not from the facility itself but from the adverse social and economic impacts resulting from poor management of population growth. A community may find that no impact assistance can compensate for development that is incompatible with its fundamental goals. However, even if a community is opposed to a facility-siting proposal, it still must be prepared to deal with the socioeconomic impacts. This preparation is a prerequisite because the community may not have authority to block a project, especially if it is located on lands over which the community has no control, such as federal lands.

In summary, direct impact assistance from energy developers can be an attractive option for communities. If mutually recognized benefits and local leverage exist, energy developers are likely to cooperate with communities in impact mitigation. Experiences in other communities show that cooperation is most likely to occur if communities identify the impacts well in advance of the project and prepare an itemized account of their needs that indicates the type and timing of the impact assistance to be provided by the developer.

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TAXATION, MINING, AND THE SEVERANCE TAX
U.S. Department of the Interior

THE SEVERANCE TAX IN PRACTICE

Since the first severance tax on minerals was adopted in 1846 by Michigan and its use broadened among States in the 1920's and 1930's, the number of States utilizing the severance tax on minerals has remained at about 25-30 in the past two decades. At the beginning of 1978, 29 States had severance taxes on minerals. Only 27 of these actually collected revenues under their severance taxes in the fiscal year 1980.

Figure 1 is a map of States that have severance taxes. The major mineral commodity groups on which severance taxes are levied also are indicated on this map. States in the northeastern part of the Nation as a group do not use the severance tax, and with the exception of Virginia, West Virginia, and Pennsylvania, they are not large mineral producing states. Iowa, Missouri, and Illinois in the midwest, and Oregon and Washington in the northwest do not have severance taxes. In the southwest and mountain area, only Arizona, an important mineral producer, does not have a severance tax. However, this is largely a matter of semantics as is pointed out elsewhere since Arizona does have an occupational gross income tax of 2.5 percent on extractive industries that is similar to a severance tax in all but name.

Data in the following tables and figures indicate the scope and coverage of severance taxes among both States and mineral commodities, as well as the significance of severance taxes in each State's total revenues and in value of mineral production in each State.

Care needs to be taken not to imply too much from the relationships indicated by these data. Severance taxes do not represent the total tax on minerals. Because a State does not have a tax classified as a severance

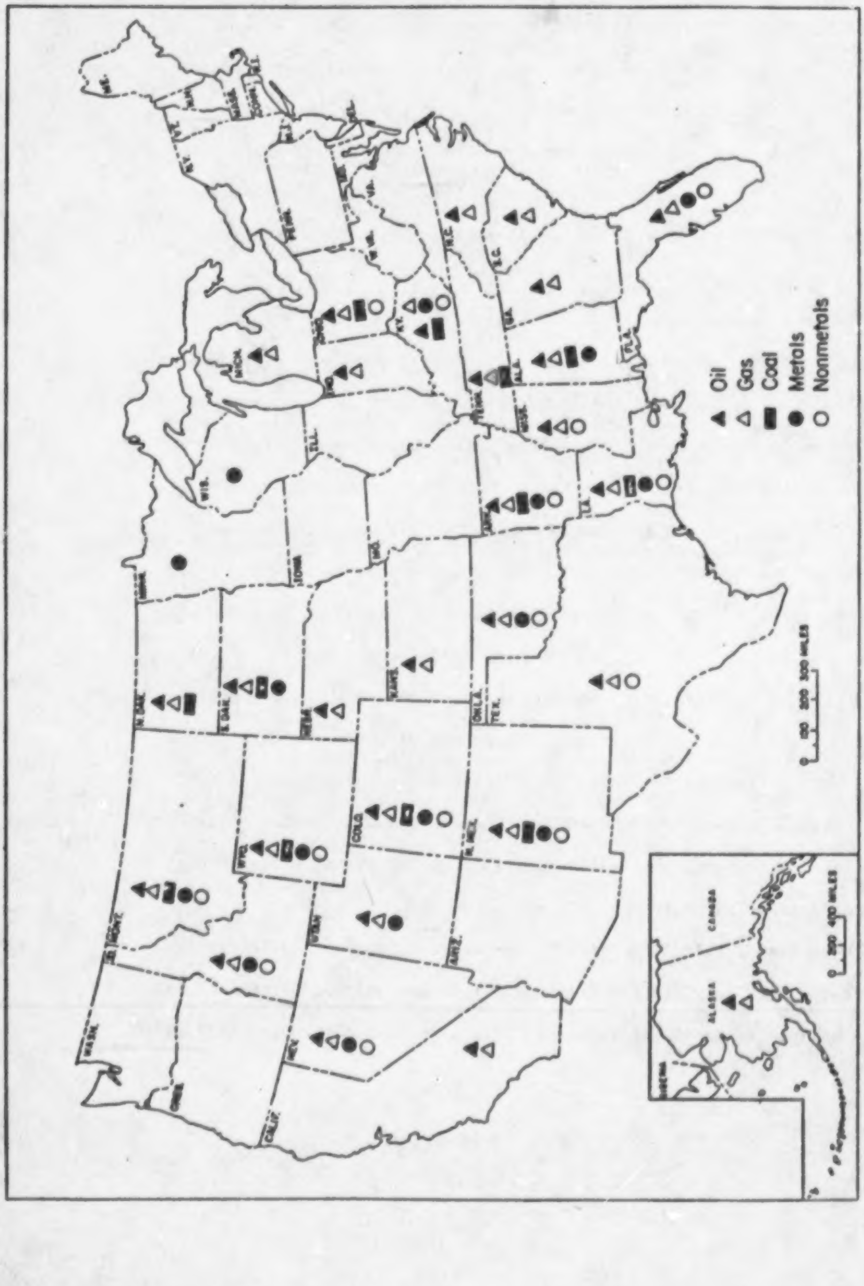
▲ Oil
△ Gas
▬ Coal
● Metals
○ Nonmetals
0 100 200 300 MILES
0 200 400 MILES
ALASKA
CANADA
SIBERIA
WASH.
OREG.
CALIF.
NEV.
IDAHO
MONT.
WYO.
UTAH
ARIZ.
COLO.
N. MEX.
N. DAK.
S. DAK.
NEBR.
KANS.
OKLA.
TEX.
MINN.
IOWA
MO.
ARK.
LA.
WIS.
ILL.
MICH.
IND.
OHIO
KY.
TENN.
MISS.
ALA.
GA.
FLA.
S.C.
N.C.
VA.
W. VA.
PENN.
N.Y.
VT.
N.H.
ME.
MASS.
CONN.
R.I.
N.J.
DEL.
MD.

FIGURE 1. - Map of States with severance tax, by major commodity groupings.

tax on minerals, does not mean it does not tax minerals; nor can a severance tax be assumed to be the only tax on minerals in those States having a severance tax. The data are based on taxes classified as severance taxes and this can be more a matter of semantics than economic effect. With this note of caution, it is believed that the following tables and figures give a useful picture of State levying severance taxes on minerals.

Table 1 indicates that of the 29 states with mineral severance taxes, 27 apply the tax to oil production (of 31 states that produce petroleum), 27 to gas production (of 31 states that produce gas), 16 to metals (of 29 states that produce metals), 14 to non-metals (all 50 states produce non-metals), and 11 to coal (of 26 states that produce coal). Taxation of oil and gas production is the major use of the severance tax. Eight states, apply their severance tax only to oil and gas production. Of these, Georgia and North Carolina had no oil or gas production in 1980, and one, California, levied the tax only for the purpose of paying the administration costs of its conservation program. Minnesota and Wisconsin's severance taxes are on specified metals only, whereas 7 States, have broadly based severance taxes on all minerals. Other States, although not having a severance tax that covers all mineral resources, in effect do tax all minerals produced in the State through severance taxes on those specific minerals.

More than 4 billion dollars in severance taxes were collected in the 1980 fiscal year (tables 2 and 3). This was about 3 percent of all State tax collections that year, or about 4 percent of the tax collections in those

TABLE 1. - State severance taxes on minerals, August 1981

State	Oil	Gas	Coal	Metals	Nonmetals
Alabama.........	x	x	x	x	
Alaska..........	x	x			
Arizona.........					
Arkansas........	x	x	x	x	x
California......	x	x			
Colorado........	x	x	x	x	x
Connecticut.....					
Delaware........					
Florida.........	x	x		x	x
Georgia.........	x	x			
Hawaii..........					
Idaho...........	x	x		x	x
Illinois........					
Indiana.........	x	x			
Iowa............					
Kansas..........	x	x			
Kentucky........	x	x	x	x	x
Louisiana.......	x	x	x	x	x
Maine...........					
Maryland........					
Massachusetts...					
Michigan........	x	x			
Minnesota.......				x	
Mississippi.....	x	x			x
Missouri........					
Montana.........	x	x	x	x	x
Nebraska........	x	x			
Nevada..........	x	x		x	x
New Hampshire...					
New Jersey......					
New Mexico......	x	x	x	x	x
New York........					
North Carolina..	x	x			
North Dakota....	x	x	x		
Ohio............	x	x	x		x
Oklahoma........	x	x		x	x
Oregon..........					
Pennsylvania....					
Rhode Island....					
South Carolina..					
South Dakota....	x	x	x	x	
Tennessee.......	x	x	x		
Texas...........	x	x			x
Utah............	x	x		x	
Vermont.........					
Virginia........					
Washington......					
West Virginia...					
Wisconsin.......				x	
Wyoming.........	x	x	x	x	x
Total:	27	27	12	16	14

Conservation purposes only.

Source: Commerce Clearing House, State Tax Guide, All States New York, Chicago, and Washington, 1967 with supplements to August 1981.

States with severance taxes. Although the evidence is mixed, the importance of severance tax collections in total State tax collections appears to be increasing, at least over the past 7 years; mineral severance taxes accounted for about 1.4 percent of total State tax collections in 1970, 1.7 percent in 1974, and 2.1 percent in 1977. Total State tax receipts increased about 111 percent between 1970 and 1977. Severance tax collections increased by about 216 percent during that period, or nearly twice as much. This differential rate of increase was somewhat wider in the last several years of the period than for the total period, suggesting an accelerating differential for severance tax collections. These figures are not adjusted for inflation, nor do they separate out the variety of causes that could account for these increases in severance tax collections. Increases seen may result from an increase in quantity of minerals produced, and increase in tax rates, extended coverage of the tax, additional States adopting the severance tax, a change in reporting classifications, or more complete reporting of production or more complete collections. The comparisons of severance tax collections to total value of minerals produced (table 7) give additional analysis of comparative tax levels and burdens.

In terms of value, severance tax collections are highly concentrated in just a few States (table 2). Texas collected the largest amount of severance taxes, $1,525 million in 1980, which was 38 percent of all severance taxes collected in the United States. Louisiana was second in importance, collecting $520 million in severance tax in 1977, about 13 percent of all severance taxes. Thus two States account for 51 percent

TABLE 2. - State severance tax collections, 1977

State	Total State tax revenues (thousands $)	Mineral severance tax revenues (thousands $)	Severance tax percent of total tax revenues	State percentage of all U.S. severance tax revenues	Severance tax location quotient
Alabama........	1,403,674	12,201	0.87	0.58	0.41
Alaska.........	773,787	23,705	3.06	1.12	1.46
Arizona........	1,160,068	*	*	*	*
Arkansas.......	802,913	9,248	1.15	0.44	.55
California.....	12,589,124	1,530	0.01	0.07	.01
Colorado.......	1,077,285	2,320	0.22	0.11	.10
Connecticut....	1,457,139	*	*	*	*
Delaware.......	390,882	*	*	*	*
Florida........	3,274,802	47,076	1.44	2.22	.69
Georgia........	1,906,506	-	-	-	-
Hawaii.........	685,703	*	*	*	*
Idaho..........	367,823	203	0.06	0.01	.03
Illinois.......	5,319,547	*	*	*	*
Indiana........	2,162,899	580	0.03	0.03	.01
Iowa...........	1,292,507	*	*	*	*
Kansas.........	969,005	816	0.08	0.04	.04
Kentucky.......	1,560,385	113,005	7.24	5.33	3.45
Louisiana......	1,714,616	492,037	28.70	23.21	13.67
Maine..........	468,462	*	*	*	*
Maryland.......	2,127,712	*	*	*	*
Massachusetts..	2,934,261	*	*	*	*
Michigan.......	4,790,719	9,459	0.20	0.45	.09
Minnesota......	2,485,565	59,718	2.40	2.82	1.14
Mississippi....	969,251	23,417	2.42	1.10	1.15
Missouri.......	1,598,094	*	*	*	*
Montana........	312,399	43,543	13.94	2.05	6.64
Nebraska.......	610,235	1,131	0.19	0.05	.09
Nevada.........	329,069	105	0.03	0.00	.02
New Hampshire..	200,231	*	*	*	*
New Jersey.....	3,103,725	*	*	*	*
New Mexico.....	597,604	102,783	17.20	4.85	8.20
New York.......	10,743,249	*	*	*	*
North Carolina.	2,384,780	-	-	-	-
North Dakota...	296,330	15,418	5.20	0.73	2.48
Ohio...........	3,570,771	3,918	0.11	0.18	.05
Oklahoma.......	1,139,000	191,351	16.80	9.03	8.01
Oregon.........	973,145	*	*	*	*
Pennsylvania...	5,590,840	*	*	*	*
Rhode Island...	438,841	*	*	*	*
South Carolina.	1,187,589	*	*	*	*
South Dakota...	200,115	536	0.27	0.03	.13

TABLE 2. - State severance tax collections, 1977--Continued

State	Total State tax revenues (thousands $)	Mineral severance tax revenues (thousands $)	Severance tax percent of total tax revenues	State percentage of all U.S. severance tax revenues	Severance tax location quotient
Tennessee......	1,529,531	2,052	.13	0.10	0.06
Texas..........	4,748,947	907,281	19.10	42.80	9.10
Utah...........	531,276	8,931	1.68	0.42	.80
Vermont........	229,803	*	*	*	*
Virginia.......	2,054,831	*	*	*	*
Washington.....	2,100,035	*	*	*	*
West Virginia..	904,400	*	*	*	*
Wisconsin......	2,733,294	698	0.03	0.03	.01
Wyoming........	233,336	46,969	20.13	2.22	9.59
Total..... (50 States)	101,026,105	2,120,031	2.10	100.00	1.00
States with severance tax..	51,773,755	2,120,031	4.09		

- No severance tax collections reported this year.

* No severance tax.

A means of indicating relative importance; 1.00 means same relative importance as in the Nation as a whole; 2.00 would mean twice as important; .50 half as important.

Source: U.S. Bureau of the Census, State Tax Collections in 1977, Series GF-77 No. 1, U.S. GPO, Washington, D.C., 1977.

of all severance taxes collected in the Nation. By comparison, the largest two States in terms of total tax collections, California and New York, together accounted for just 23 percent of total State tax collection. Other States with large severance tax revenues included Alaska with $506 million, 12.6 percent of total U.S. severance taxes; Oklahoma with $436 million, 10.8 percent; New Mexico, $214 million, 5.3 percent; and Kentucky, $177 million, 4.4 percent. States in the intermediate range of importance in amount of severance taxes collected include Florida, $121 million, or 3.0 percent of total severance tax collections; Wyoming, $106 million, or 2.6 percent; Montana, $95 million, or 2.3 percent, and Minnesota with $83 million, or 2.1 percent. These figures should not be misinterpreted to imply that the States with the largest total collections from the severance tax are necessarily those States which impose the highest severance tax rates. They are more frequently States with the larger amount of mineral production. Comparisons must be made between the tax rates, bases, and exemptions of tables 10-14, the collection data of table 2, and the mineral production data of table 4 for a more accurate picture of individual State application of the severance tax.

In terms of the importance of severance tax revenues to total tax revenues within individual States, the rankings of States are different. Severance taxes were most significant in Louisiana, where they were 29 percent of all taxes collected in the State in 1977. In Wyoming, severance taxes provided 20 percent of all State tax revenues; in Texas, 19 percent; 17 percent in New Mexico and in Oklahoma; 14 percent in Montana; 7 percent in Kentucky; 5 percent in North Dakota; and 3 percent in Alaska. Severance taxes accounted for about 2.5 percent of all tax revenues in Minnesota, and Mississippi. In only three other States, Arkansas, Florida and Utah, did the severance tax account for as much as 1 percent of total State tax collections. Thus, severance taxes provided 10 percent or more of total State tax revenue in just five States whereas it provided between 1 and 7 percent in eight other States.

Total size of State revenues is as important in establishing these percentages as is the amount of severance tax collected.

When severance tax collections are divided into major commodity groupings of oil and gas, coal, metals, and nonmetals (table 3), the most striking feature is, again, the high concentration of severance tax receipts derived from the production of oil and gas. Severance taxes on oil and gas provide 87 percent of all severance tax collections, coal production provides 8 percent, and production of metals and non-metals another 5 percent. Fifteen of the 27 States having revenues from severance taxes in 1977 received 80 to 100 percent of that revenue from the tax on oil and gas production (100 percent for eight States). Coal provided one-third or more of severance tax receipts for five States (100 percent for 2). Eight of the 27 states with severance tax revenues saw metallic and nonmetallic mineral production as the source for 25 percent or more of that revenue (4 received 100 percent of their severance tax revenue from these sources).

TABLE 3. - State severance tax collections by commodity groupings, 1977

State	Severance tax (thousands $)				Percent of total		
	Total	Oil & gas	Coal	Metals & nonmetals	Oil & gas	Coal	Metals & nonmetals
Alabama	$ 12,201	11,529	672		94	6	0
Alaska	23,705	23,705			100	0	0
Arkansas	9,248	8,124	10	1,114	88	*	12
California	1,530	1,530			100	0	0
Colorado	2,320	2,244	76		97	3	0
Florida	47,076	26,439		20,637	56	0	44
Georgia	-	-	-	-	-	-	-
Idaho	203			203	0	0	100
Indiana	580	580			100	0	0
Kansas	816	816			100	0	0
Kentucky	113,005	408	112,597		*	100	0
Louisiana	492,037	485,339		6,698	99	0	1
Michigan	9,459	9,459			100	0	0
Minnesota	59,718			59,718	0	0	100
Mississippi	23,417	23,417			100	0	0
Montana	43,543	6,884	34,470	2,189	16	79	5
Nebraska	1,131	1,131			100	0	0
Nevada	105			105	0	0	100
New Mexico	102,783	100,418	499	1,866	98	*	2
North Carolina	-	-	-	-	-	-	-
North Dakota	15,418	9,288	6,130		60	40	0
Ohio	3,918	1,146	1,531	1,241	29	39	32
Oklahoma	191,351	191,351			100	0	0
South Dakota	536	58		478	11	0	89
Tennessee	2,052		2,052		0	100	0
Texas	907,281	902,801		4,480	99	0	1
Utah	8,931	6,441		2,490	72	0	28
Wisconsin	698			698	0	0	100
Wyoming	46,969	39,074	5,087	2,809	83	11	6
Total	$2,120,031	1,852,182	163,124	104,726	87	8	5

* Less than 1 percent.

- No severance tax collections in 1977.

Source: Bureau of the Census, State Tax Collections in 1977, Bureau of Census unpublished data, various State Revenue departments. Figures for the States of Arkansas, New Mexico, and Wyoming are estimates based on State data that did not coincide exactly with Bureau of Census data.

Of the 16 States with severance tax revenues of $9 million or more in 1977, ten received 80 percent or more from oil and gas production, two (Kentucky and Montana) received 75 percent or more from coal production, and two (Florida and Minnesota) received 40 percent or more from metallic and non-metallic mineral production. Six of the top ten severance tax receiving States derived most of their severance taxes from oil and gas, two from coal, one from metal, and one about evenly divided between oil and gas and non-metals.

States with severance taxes produced 86 percent of the Nation's minerals by value in 1980 (table 4). States without severance taxes produced 14 percent of the mineral value. It might be expected that there would be a close correlation between States with a significant mineral production and those which impose a special tax on this mineral production, such as a severance tax. This is generally the case, with some exceptions. Of the 21 States that produced 1 percent or more of the Nation's mineral value in 1980, or almost 92 percent of all minerals, 16 have severance taxes. The major exceptions are West Virginia, which produced 3.2 percent of the Nation's mineral value; Pennsylvania, 2.6 percent; Illinois, 2.5 percent; Arizona, 1.7 percent; and Virginia, 1.2 percent. It should be noted again that merely because these States do not have a tax on mineral production that is called a severance tax, does not mean minerals produced in those States are not as fully taxed as minerals produced in States with severance taxes. Arizona, for example, applies an occupation tax on gross proceeds or gross income from mining that is very similar to a severance tax, and West Virginia imposes a similar occupation or sales tax on gross proceeds or gross income from mining. Oil- and gas-producing States tend to lead in total value of mineral production, and coal-producing States follow in importance.

TABLE 4. - Value of mineral production, 1980 1/

State	States with severance tax: Value of mineral product, millions	States with severance tax: State mineral production as a percentage of total U.S. mineral production	State	States without severance tax: Value of mineral product, millions	States without severance tax: State mineral production as a percentage of total U.S. mineral production
Alabama..............	$2,049	1.46	Arizona.............	$2,703	1.92
Alaska...............	10,002	7.12	Connecticut.........	66	.05
Arkansas.............	859	.61	Delaware............	2	.00
California...........	10,539	7.50	Hawaii..............	60	.04
Colorado.............	2,632	1.87	Illinois............	2,878	2.05
Florida..............	2,520	1.79	Iowa................	264	.19
Georgia..............	771	.55	Maine...............	37	.03
Idaho................	522	.37	Maryland............	289	.20
Indiana..............	1,108	.79	Massachusetts.......	91	.06
Kansas...............	2,943	2.09	Missouri............	1,159	.82
Kentucky.............	4,775	3.40	New Hampshire.......	25	.02
Louisiana............	16,532	11.76	New Jersey..........	149	.11
Michigan.............	2,556	1.82	New York............	552	.39
Minnesota............	1,782	1.27	Oregon..............	150	.11
Mississippi..........	1,158	.82	Pennsylvania........	4,005	2.85
Montana..............	1,284	.91	Rhode Island........	6	.00
Nebraska.............	274	.19	South Carolina......	195	.14
Nevada...............	405	.29	Vermont.............	43	.03
New Mexico...........	5,015	3.57	Virginia............	1,945	1.38
North Carolina.......	379	.27	Washington..........	306	.22
North Dakota.........	1,251	.89	West Virginia.......	5,011	3.57
Ohio.................	2,272	1.62			
Oklahoma.............	7,529	5.36			
South Dakota.........	252	.18			
Tennessee............	727	.52			
Texas................	33,209	23.64			
Utah.................	1,720	1.22			
Wisconsin............	152	.11			
Wyoming..............	5,366	3.82			
Total............	120,583	85.82	Total..........	19,936	14.18

1/ Total value of U.S. mineral production in 1980, $140,519 million.

Source: Unofficial estimate of 1980 value of mineral production, by State, is author's compilation from various sources: nonfuel minerals data from U.S. Bureau of Mines; petroleum value estimates from the Independent Petroleum Association of America; natural gas, coal, and uranium values adapted from published Department of Energy production and price figures, 1980 company annual reports; and personal communications. Estimates will not necessarily correspond to final published 1980 data from these or other sources.

One of the choices States have in levying a mineral severance tax is the base to which it is applied. A mineral can be taxed on the basis of physical units produced, such as barrels or tons, or on the basis of value of production. There appears to be a preference for using value as the base of severance taxes (table 5). In the application of severance taxes to oil and gas production, States are using value as a base twice as frequently as they use a unit base. For metals and non-metals, a per value base is three times more common than a per unit base. Seven states taxing coal with a severance tax, however, apply their tax on a per unit basis while only three utilize a per value base. Several States tax specific commodities on both a value and unit basis or on an either/or basis whichever yields the greater revenue.

A per value base has the advantage of yielding increased revenues as the price of the commodity taxed increases whereas a per unit tax must be revised in order to yield more revenue, unless tied to price index. A comparison of minerals taxed under a severance tax with the principal minerals produced in each State indicates that nonmetallics, particularly stone and sand and gravel production, are least likely to be taxed by a mineral severance tax (table 6), and States in which sand and gravel and other nonmetallics are the principal minerals produced in terms of value are less likely to have severance taxes. Only one State (Illinois) in which petroleum is among the major minerals produced, does not have a severance tax.

Data that would permit an analysis of the relative burden of severance tax on individual mining firms and subsequently its influence in their costs and decision-making process arevery limited and generally unavailable. The

TABLE 5. - Basis of severance tax, unit or value, by State and major commodity

State	Oil	Gas	Coal	Metals	Nonmetals
Alabama.........	x	x	o	o	
Alaska..........	x o	x o			
Arkansas........	x o	o	o	o	x o
California......	o	o			
Colorado........	x	x	o	x o	x
Florida.........	x	x		x	x
Georgia.........	o	o			
Idaho...........	o	o		x	x
Indiana.........	x	x			
Kansas..........	o	o			
Kentucky........	x	x	x	x	x
Louisiana.......	x	x o	o	o	o
Michigan........	x	x			
Minnesota.......				x o	
Mississippi.....	x o	x o			x
Montana.........	x	x	x o	x	x o
Nebraska........	x	x			
Nevada..........	o	o		x	x
New Mexico......	x	x o	x o	x o	x
North Carolina..	o	o			
North Dakota....	x	x	o		
Ohio............	o	o	o		o
Oklahoma........	x	x o		x	x
South Dakota....	x	x	x	x	
Tennessee.......	x	x	o		
Texas...........	x o	x			o
Utah............	x	x		x	
Wisconsin.......				x	
Wyoming.........	x	x	x	x	x
Totals.....	x 16	x 14	x 3	x 10	x 9
	o 7	o 8	o 7	o 3	o 3
	xo 4	xo 5	xo 2	xo 3	xo 2

Legend:
x = value
o = unit
xo = both

Source: Commerce Clearing House, State Tax Guide, All States, updated to August 1981.

TABLE 6. - Principal mineral products of each State and minerals taxed by severance tax

State	Principal minerals in order of value	Minerals taxed under severance tax
Alabama.........	Coal, petroleum, cement, stone	Iron ore, petroleum, natural gas, coal
Alaska..........	Petroleum, sand and gravel, natural gas, stone	Petroleum, natural gas
Arizona..	Copper, molybdenum, sand and gravel, silver	None
Arkansas........	Petroleum, bromine, stone, natural gas	All minerals
California......	Petroleum, natural gas cement, sand and gravel	Petroleum, natural gas
Colorado........	Petroleum, molybdenum, coal, sand and gravel	Petroleum, natural gas, coal, molybdenum, oil shale, all metals
Connecticut.....	Stone, sand and gravel, feldspar, lime	None
Delaware........	Sand and gravel, clays	None
Florida.........	Phosphate rock, petroleum, stone, cement	Petroleum, natural gas, phosphate rock, lime, stone, sand and gravel
Georgia.........	Clays, stone, cement, sand and gravel	Petroleum, natural gas
Hawaii..........	Stone, cement, sand and gravel, pumice	None
Idaho...........	Silver, phosphate rock, zinc, lead	Petroleum, natural gas, all ores
Illinois........	Coal, petroleum, stone, sand and gravel	None
Indiana.........	Coal, cement, stone, petroleum, sand and gravel	Petroleum, natural gas, other hydrocarbons
Iowa............	Cement, stone, sand and gravel, gypsum	None
Kansas..........	Petroleum, natural gas, natural gas liquids, cement	Petroleum, natural gas
Kentucky........	Coal, stone, petroleum, natural gas	Petroleum, coal
Louisiana.......	Petroleum, natural gas, natural gas liquids, salt	All natural resources (petroleum, natural gas, butane, propane, stone, coal, sand and gravel, marble, ores, salt, sulfur)
Maine...........	Sand and gravel, cement, stone	None
Maryland........	Stone, cement, sand and gravel, coal	None; Allegany County - natural gas
Massachusetts...	Stone, sand and gravel, lime, clays	None
Michigan........	Iron, cement, copper, sand and gravel	Petroleum, natural gas
Minnesota.......	Iron, sand and gravel, stone,	Iron ores, other ores, taconite, semi-taconite, iron sulphide, copper-nickel
Mississippi.....	Petroleum, natural gas, sand and gravel, cement	Petroleum, natural gas, salt
Missouri........	Lead, cement, stone, iron	None
Montana.........	Petroleum, coal, copper, natural gas, silver	All minerals (coal, all metals, precious and semiprecious gems, petroleum, natural gas, micaceous minerals, cement, gypsum)

TABLE 6. - Principal mineral products of each State and minerals taxed by severance tax --Continued

State	Principal minerals in order of value	Minerals taxed under severance tax
Nebraska.........	Petroleum, cement, sand and gravel, stone	Petroleum, natural gas
Nevada...........	Copper, gold, sand and gravel, diatomite	All minerals, petroleum, natural gas
New Hampshire...	Sand and gravel, stone clays, gemstones	None
New Jersey......	Stone, sand and gravel, zinc, titanium concentrates	None
New Mexico......	Petroleum, natural gas, copper, natural gas liquids, uranium, potassium salts	All minerals (lead, silver, zinc, fluorspar, clay, sand and gravel, oil, gas) potash, molybdenum, uranium, copper, gold
New York........	Cement, stone, sand and gravel, salt	None
North Carolina..	Stone, sand and gravel, cement, feldspar	Petroleum, natural gas
North Dakota....	Petroleum, coal, sand and gravel, natural gas	Petroleum, natural gas, coal
Ohio............	Coal, stone, lime, sand and gravel, cement	Coal, salt, limestone, dolomite, sand and gravel, petroleum, natural gas
Oklahoma........	Petroleum, natural gas, natural gas liquids, stone	Petroleum, natural gas, asphalt, lead, zinc, jack, silver, gold, uranium, copper
Oregon..........	Stone, sand and gravel, cement, nickel	None
Pennsylvania....	Coal, cement, stone, lime, natural gas	None
Rhode Island....	Sand and gravel, stone, gemstones	None
South Carolina..	Cement, stone, sand and gravel, clays	None
South Dakota....	Gold, cement, stone, sand and gravel	None
Tennessee.......	Coal, stone, zinc, phosphorous	All minerals
Texas...........	Petroleum, natural gas, natural gas liquids, cement	Petroleum, natural gas, coal
Utah............	Copper, petroleum, coal, gold	Petroleum, natural gas, sulphur, cement
		All metals (gold, silver, copper, lead, iron, zinc, tungsten, uranium) petroleum, natural gas, other hydrocarbons
Vermont.........	Stone, asbestos, sand and gravel, talc	None
Virginia........	Coal, stone, sand and gravel, cement	None
Washington......	Cement, sand and gravel, coal, stone	None
West Virginia...	Coal, natural gas, petroleum, stone	One
Wisconsin.......	Sand and gravel, stone, iron, cement,	Copper
Wyoming.........	Petroleum, coal, trona, natural gas, uranium	Petroleum, natural gas, gold, silver, other precious metals, soda, saline, uranium, bentonite, coal, trona, oil shale, other fossil fuels, other valuable deposits

Source: U.S. Bureau of Mines, Minerals Yearbook, 1978-79
Commerce Clearing House, State Tax Guide, All States, New York, Chicago, and Washington, 1967 (with updated supplements to August 1981).

comparisons of severance tax collections and the value of mineral production in each State (table 7) are intended as an indication of the relative size of the severance tax and total revenues of mining firms from which some limited implications of burden can be drawn. The 1980 severance tax collection of $4 billion was about 3.3 percent of the $121 billion total value of mineral production in severance tax States that year. Considerable variation exists between States. Severance tax collections were the largest share of the total value of mineral production in South Dakota, where the severance tax was 9.5 percent of total value of minerals produced. In Montana the ratio was 7.4 percent; Oklahoma 5.8 percent; Alaska, 5.1 percent; Florida 4.8 percent; Minnesota 4.7 percent; Texas, 4.6 percent and Mississippi, 4.3 percent. At the other end of the scale, California severance tax collections were only 0.03 percent of value of mineral production, reflecting California's use of this tax for conservation purposes rather than revenue raising. Kansas and Nevada also had very low ratios of 0.03 and 0.04 respectively.

The data in table 7 also tempt one to look for a positive correlation between size of mineral production in a State and the portion of it that is claimed by the State in severance taxation. All States with mineral production of more than $4 billion in 1980 did have a severance tax collection of more than 3 percent, except California, Wyoming, and of course, Pennsylvania and West Virginia which have no severance tax as defined in this study. However, a number of small producing States also

TABLE 7. - State severance taxes as a share of mineral production value, 1980

State	Value of mineral production, millions	Mineral severance tax, millions	Severance tax as percent of State's mineral production
Alabama	2,249	30.6	1.5
Alaska	10,002	506.4	5.1
Arkansas	859	16.2	1.9
California	10,539	3.5	.03
Colorado	2,632	31.1	1.2
Florida	2,520	121.2	4.8
Georgia	771	(1)	--
Idaho	522	1.9	.4
Indiana	1,108	1.6	.1
Kansas	2,943	1.1	.03
Kentucky	4,775	177.2	3.7
Louisiana	16,532	519.7	3.1
Michigan	2,556	43.3	1.7
Minnesota	1,782	83.4	4.7
Mississippi	1,158	50.2	4.3
Montana	1,284	94.6	7.4
Nebraska	274	2.9	1.0
Nevada	405	.2	.04
New Mexico	5,015	213.6	4.2
North Carolina	379	(1)	--
North Dakota	1,251	43.9	3.5
Ohio	2,272	4.6	2.0
Oklahoma	7,529	436.0	5.8
South Dakota	252	2.4	9.5
Tennessee	727	2.2	3.0
Texas	33,209	1525.1	4.6
Utah	1,720	10.6	.6
Wisconsin	152	.4	2.6
Wyoming	5,366	105.7	2.0
Total	120,583	4029.6	3.34

1 No severance tax collections on minerals in 1980

Source: Tables 2, 4.

collected a relatively large amount of severance tax while some middle-sized producers collected a relatively small amount of severance tax. The evidence of this table does not seem to substantiate the hypothesis of a positive relationship between size of mineral industry in a State and proportion of its revenues appropriated by the State as severance tax.

A relatively few States dominate mineral production in this country and there is an even greater degree of concentration in severance tax collections among a few States (table 8). Two-thirds of the Nation's minerals by value is produced in eight States (all producers of fuels-oil, gas, or coal); 90 percent of its mineral value by 18 States. The greater degree of concentration in severance tax collection is seen in the fact that one-half of total severance tax revenues in 1980 were collected by just two States (Texas and Louisiana, which were also the two largest mineral producers) and just eight States received 90 percent of all severance tax revenues.

The severance tax has had increasing importance in the tax revenues of those States that are the major recipients of tax revenues from this source (table 9). The contribution of severance tax revenues to total revenues rose from an estimated average of 2.7 percent in 1970 for all States having severance taxes to about 4.1 percent in 1977. The median share of severance tax to total tax receipts for all severance tax States rose from about 0.2 percent to 1.2 percent, still not an impressive share of total tax receipts at the median. If we arbitrarily assume that about 5 percent of the total is a significant contribution, however, the number

TABLE 8. - Relative dominance of States in value of mineral production and severance tax collection, 20 major mineral-producing States, 1980

State	Total value of State mineral production, (millions)	Percentage of U.S. mineral production	Cumulative percentage	Severance tax, (millions)	Percentage of total U.S. severance taxes
Texas..........	$33,209	23.6	23.6	$1,525	37.8
Louisiana.....	16,532	11.8	35.4	520	12.9
California....	10,539	7.5	42.9	4	.1
Alaska.........	10,003	7.1	50.0	506	12.6
Oklahoma......	7,529	5.4	55.4	436	10.8
Wyoming........	5,366	3.8	59.2	106	2.6
New Mexico....	5,015	3.4	62.6	214	5.3
West Virginia.	5,011	3.4	66.0	(1)	(1)
Kentucky.......	4,775	3.4	69.4	177	4.4
Pennsylvania..	4,005	2.8	72.2	(1)	(1)
Kansas.........	2,943	2.1	74.3	1	.02
Illinois.......	2,878	2.0	76.3	(1)	(1)
Arizona........	2,703	1.9	78.2	(1)	(1)
Colorado.......	2,632	1.9	80.1	31	.8
Michigan.......	2,556	1.8	81.9	43	1.1
Florida........	2,520	1.8	83.7	121	3.0
Ohio...........	2,272	1.6	85.3	5	.1
Alabama........	2,049	1.4	86.7	31	.8
Virginia.......	1,945	1.4	88.1	(1)	(1)
Minnesota.....	1,782	1.3	89.4	83	2.0

(1) State does not have a severance tax.

NOTE.--15 States with severance tax = 78 percent of U.S. mineral production.
5 States without severance tax = 12 percent of U.S. mineral production.

Source: Table 7.

TABLE 9. - Changing share of severance taxes in total State tax collections--1970, 1975, 1977

1970 (percent)		1975 (percent)		1977 (percent)	
Louisiana	29.3	Louisiana	35.6	Louisiana	28.7
Texas	14.2	Texas	18.3	Wyoming	20.1
New Mexico	13.3	Oklahoma	14.5	Texas	19.1
Oklahoma	10.1	New Mexico	13.4	New Mexico	17.2
Wyoming	5.0	Alaska	13.1	Oklahoma	16.8
Montana	3.7	Wyoming	11.8	Montana	13.9
North Dakota	2.6	Kentucky	7.7	Kentucky	7.2
Minnesota	1.9	Montana	6.3	North Dakota	5.2
Utah	1.7	North Dakota	2.6	Alaska	3.1
Arkansas	1.0	Mississippi	2.6	Minnesota	2.4
Nebraska	0.3	Minnesota	1.8	Mississippi	2.4
Colorado	0.2	Utah	1.6	Utah	1.7
Alabama	0.2	Florida	1.1	Florida	1.4
Idaho	0.2	Arkansas	1.0	Arkansas	1.2
Kansas	0.1	Alabama	0.9	Alabama	0.9
Average all States with severance tax	2.7 (est.)	Average all States with severance tax	4.1	Average all States with severance tax	4.1
Median all States with severance tax	0.2	Median all States with severance tax	0.9	Median all States with severance tax	1.2

Source: U.S. Bureau of the Census, State Tax Collections in 1970, in 1975, and in 1977 of States in which severance taxes are significant rose from five in 1970 to eight in 1977. If 10 percent seems more significant, the number of States so classified increased from four in 1970 to six in 1977. For individual States, the change in importance of the severance tax is more dramatic. In 1970, 5 percent of Wyoming's total State tax collections came from the severance tax; in 1977, the severance tax share was 20 percent. In Montana, the severance tax share of total State tax collections increased from about 3.7 percent in 1970 to 13.9 percent in 1977. The increased productivity of severance taxes is the result not only of increased production of minerals, particularly coal in the case of Montana and Wyoming, but also an increase in per unit value of minerals taxed and an increase in the rates of severance taxes levied in a number of States, Montana being an example.

In tables 10 through 14, the severance tax laws of all 29 States that impose such a tax on minerals are subdivided into five sub-tables that permit a comparison of the various features of each State's severance tax by major commodity groupings-oil, gas, coal, metals and nonmetals. The difference in treatment among the individual States is apparent. Many States have a single tax and a single rate for each commodity taxed; others have a number of severance taxes that apply to a particular commodity. New Mexico, for example, has four taxes on oil and five on gas. Minnesota has four on iron ores plus several additional taxes within these. The tax rate and base may be simple, as for example Tennessee's $0.20 per ton tax on coal, or it may be complex as in Montana's tax on coal, which varies according to the heating quality of the coal mined and whether it is mined by surface or underground methods with choice of a per ton or value basis, whichever yields the greater tax.

Severance taxes on oil are commonly between 2 percent and 6 percent of gross value, but range from 1 percent in Indiana to 12.5 percent in Louisiana. Some are in lieu of all other State taxes; others are in addition to all other taxes. Some are to pay for specific purposes such as conservation; others are simply to raise revenue for the State. Comparison of rates is not very meaningful unless differences in base and exemption can be netted out to arrive at an effective rate per some common unit.

Oil and gas are generally lumped together in severance tax legislation and have a similarity in rates, bases, and other provisions. No State taxes one (oil) and not the other.

Severance tax rates on coal range from $0.02 per ton in Arkansas, which is also in lieu of all other privilege or excise taxes, to $0.60 per ton of surface mined coal in Colorado, which rate also is tied to the wholesale price index to provide for a 1 percent change in the rate for every 3 point change in the wholesale price index, and 30 percent of value for surface mined coal containing over 9,000 Btu/lb in Montana.

TABLE 10. - Mineral severance taxes--rates, bases, other features--oil

State	Tax	Base	Rate	Other features
Alabama.......	Oil and gas severance.......	Gross value.........	6 pct	4 pct for well producing less than 40 bbls/day and for first 10 years for wells brought into production after 9-1-79. Increase limited to wells of certain depth.
	Oil and gas production......	......do............	2 pct	
Alaska........	......do.....................	......do............	12.25 pct or	Multiplied by the economic limit factor (1 minus the ratio of the monthly production rate at the economic limit to the production during the month for which the tax is paid). Per barrel tax varies with API gravity. In lieu of all other State and municipal taxes except conservation and income taxes.
		Per barrel.........	$0.60 (for old crude)	
		......do............	$0.80 (other) (whichever is greater)	
	Regulation and conservation.	......do............	$0.00125	
Arkansas......	Natural resources severance.	Market value........	4 pct if 10 bbl/day 5 pct if more than 10 bbl/day	Plus an additional $0.005 and $0.020 per barrel. No other privilege or excise tax on oil. Credit allowed for cost of salt water disposal system.
	Oil and gas conservation....	Per barrel..........	$0.020	Not to exceed $0.025/bbl. Rate as of May 1, 1981, $0.020/bbl. $150 and $300 fee for each well drilled.
California.....	Oil and gas production......	......do............	$0.016	Rate determined annually by Department of Conservation, based upon conservation cost; 1981 rate, $0.01639. In addition to all other taxes.
Colorado.......	Severance....................	Gross income of—		Credit allowed for some ad valorem taxes. Wells producing less than 10 bbl/day exempted. Credit allowed for contributions to local governments.
		Less than $25,000...	2 pct	
		$25,000-$100,000....	3 pct	
		$100,000-$300,000...	4 pct	
		Over $300,000.......	5 pct	
	Oil and gas conservation....	Market value........	0.09 pct	Not to exceed 0.1 pct. As of August 11, 1981, rate is $0.0009 per $1 market value. Current hearings expected to reduce this to $0.0006.
Florida........	Oil and gas production......	Gross value.........	8 pct	Includes royalty interest. Wells producing less than 100 bbls/day, or by tertiary methods, 5%.
Georgia........	......do.....................	Per barrel..........	$0.005	
Idaho..........	......do.....................	......do............	$0.005	Rate set annually by Gas Conservation Commission, not to exceed $0.005 per barrel. United States, Idaho, and Indian interests exempted as is oil used in production.
	Additional oil and gas production..................	Market value........	2 pct	
Indiana........	Petroleum production........	Value................	1 pct	In addition to all other taxes.
Kansas.........	Oil and gas production......	Per barrel...........	$0.004	Prevention of stream pollution, $0.001; conservation, $0.003.
Kentucky.......	Oil production...............	Market value.........	4.5 pct	At point when first transported; counties may impose similar tax not to exceed 1 pct, and 61 counties do so. Credit allowed on new fields.
Louisiana......	Natural resources severance.	Value................	12.5 pct	Value if the higher of gross receipts less transportation posted field price at time and place of severance. Rate is reduced for low capacity wells. Distillate, condensate, etc., produced with oil taxed at same rate. Credit allowed on new fields.
Michigan.......	Gas and oil severance.......	Gross market value...	7.6 pct	6.6 pct of gross cash market value plus a fee not to exceed 1 pct of value of oil produced the previous year. Stripper wells pay 4 pct of gross cash market value, plus 1 pct.

Mississippi	Oil and gas severance	Per barrel	$0.06 or	In lieu of all ad valorem taxes.
		Market value	6 pct (whichever is greater)	
		Per barrel	$0.008	Oil and Gas Board Maintenance Tax not to exceed 8 mills per barrel.
Montana	Oil or gas producers severance.	Gross value	5 pct	Rate increases to 6 pct, March 31, 1983.
		Market value	0.05 pct	Conservation tax. Maximum rate is 0.2 pct of market value. 1981 rate, 0.05 pct.
	Mineral mining	Gross value	0.5 pct	$25 plus 0.05 pct on gross value over $5,000.
Nebraska	Oil and gas severance	Value	3 pct	Oil used in production exempt. Well producing 10 bbls/day or less pay 2 pct of value.
	Oil and gas conservation	do	0.1 pct	Not to exceed 0.4 pct. Rate as of July 1, 1980, 0.1 pct.
Nevada	do	Per barrel	$0.005	
New Hampshire	Refined petroleum products	Net proceeds	0.1 pct	All refined petroleum products produced from crude petroleum in New Hampshire.
New Mexico	Oil and gas severance	Value	3.75 pct	Including liquid hydrocarbons removed from natural gas.
	Oil and gas privilege	Value	2.55 pct	Royalties paid to the United States, State, and Indians, exempted as are transportation costs and products taxed under occupational gross income tax.
	Oil and gas conservation	do	0.19 pct	May be raised or lowered depending on amount in conservation fund.
	Oil and gas ad valorem production.	do	Rate certified to Oil and Gas Accounting Commission.	Local ad valorem rate is applied to assessed valuation less certain deductions. In lieu of all other ad valorem taxes except on equipment.
North Carolina	Oil and gas conservation	Per barrel	$0.005	Fee of $50 for each well drilled, $15 for each well abandoned.
North Dakota	Oil and gas production	Gross value	5 pct	In lieu of State and local property taxes. Includes royalty interests
	Oil extraction	do	6.5 pct	Listed exemptions.
Ohio	Resource severance	Per barrel	$0.03	
Oklahoma	Oil, gas, and mineral gross production.	Gross value	7.085 pct	Paid by purchasers at time of production or by producer if not sold at time of production. Adjustment for low-producing wells.
South Dakota	Energy minerals severance	Taxable value	4.5 pct	In lieu of all other mineral taxes except sales, use, and property taxes. Federal, State, and local royalty interest exempted.
Tennessee	Oil and gas severance	Sales price	1.5 pct	Drilling fee $50.
Texas	Oil production	Market value	4.6 pct	Paid by first purchaser unless oil is unsold for 1 month, then by producer.
		Per barrel	$0.001875	Additional tax imposed.
Utah	Mining occupation	Gross value	2 pct	Annual exemption of $50,000 for each well.
	Oil and gas conservation	Market value	0.15 pct	Not to exceed 0.2 pct; United States, State, and Indian interests exempted.
Wyoming	Mining excise and severance.	Gross value—		
		10 bbl/day or less	4 pct	
		More than 10 bbl/day.	6 pct	
	Oil and gas production	Gross value	0.03 pct	Rate set by Oil and Gas Conservation Commission, not to exceed 0.08 pct; United States, State, and Indian interests exempted.

TABLE 11. - Mineral severance taxes--rates, bases, other features--gas

State	Tax	Base	Rate	Other features
Alabama........	Oil and gas conservation....	Gross value..........	6 pct	All wells brought into production after 9-1-79 taxed at 4% for first 10 yrs., then 6%, depending on depth.
	Oil and gas production......	.....do..............	2 pct	
Alaska..........	.....do......................	.....do..............	10 pct or	Multiplied by the economic limit factor (see table 10, Alaska).
		Per 1,000 cu ft......	$0.064 (whichever is greater)	
Arkansas.......	Natural resources severance.	.....do..............	$0.003	No other privilege or excise tax on gas.
	Oil and gas conservation....	.....do..............	$0.0025	No to exceed $0.005/mcf. Rate as of May 1, 1981, $0.0025/mcf. $150-$300 fee for each well drilled.
California.....	Oil and gas production......	Per 10,000 cu ft.....	$0.016	Rate determined annually be Department of Conservation, based upon conservation cost; 1981 rate, $0.01639. In addition to all other taxes.
Colorado.......	Severance....................	Gross income of--		Credit allowed for some ad valorem taxes. Credit allowed for contributions to local governments.
		Less than $25,000....	2 pct	
		$25,000-$100,000.....	3 pct	
		$100,000-$300,000....	4 pct	
		Over $300,000........	5 pct	
	Oil and gas conservation....	Market value.........	0.06 pct	Not to exceed 0.1 pct.
Florida........	Oil and gas production......	Gross value..........	5 pct	Includes royalty interest.
Georgia........	.....do......................	Per 1,000 cu ft......	$0.0005	
Idaho..........	.....do......................	Per 50,000 cu ft.....	$0.005	Rate set annually by Gas Conservation Commission, not to exceed $0.005 per 50,000 cu ft. United States, State, and Indian interests exempted as is gas used in production.
	Additional oil and gas production.	Market value.........	2 pct	
Indiana........	Petroleum production........	Value................	1 pct	In addition to all other taxes. Gas used in production exempted.
Kansas.........	Oil and gas production......	Per 1,000 cu ft......	$0.00085	Prevention of stream pollution, $0.00005; conservation, $0.0008.
Kentucky.......	Natural resources severance.	Gross value..........	4.5 pct	
Louisiana......	.....do......................	Per 1,000 cu ft--		Credit allowed on new fields.
		Wells of 15.025 lb/sq in.	$0.07	
		Wells of 50 lb/sq in.	$0.03	
		Wells incapable of producing 250,000 cu ft/day.	$0.013	
		Gross value..........	12.5 pct	Distillate, condensate, etc., severed with gas.
		Per barrel...........	$0.10	Natural gasoline, casinghead gasoline, and other natural gas liquids, ethane, or methane recovered through processing gas after separation of oil, distillate, etc.
		.....do..............	$0.05	Butane and propane recovered through processing gas.
Maryland (Allegany County).	....	Market value.........	7 pct	The State of Maryland does not impose a severance tax; Allegany County, Md., does.
Michigan.......	Gas and oil severance.......	Gross market value...	6 pct	The Gas and Oil Severance Tax is 5 pct, plus a fee not to exceed 1 pct of value of oil produced the previous year.

Mississippi....	Oil and gas severance.......	Value.................	6 pct or	Casinghead gas included. In lieu of all ad valorem taxes.
		Per 1,000 cu ft......	$0.003 (whichever is greater)	
		......do...............	$0.0008	Oil and Gas Board Maintenance not to exceed 0.0008 mill per 1,000 cu ft.
Montana........	Oil or gas producers severance.	Gross value..........	2.65 pct	Limited exemption for deep wells drilled after specified date.
		Market value.........	0.05 pct	Conservation tax. Maximum rate is 0.2 pct of market value.
	Mineral mining..............	Gross value..........	0.5 pct	$25 plus 0.5 pct on gross value over $5,000.
Nebraska.......	Oil and gas severance.......	Value.................	3 pct	Gas used in production exempt.
	Oil and gas conservation....	......do..............	0.1 pct	Not to exceed 0.4 pct. Rate as of July 1, 1980, 0.1 pct.
Nevada..........	......do......................	Per 50,000 cu ft.....	$0.005	
New Mexico.....	Oil and gas severance.......	Per 1,000 cu ft......	$0.126	A surtax based on the consumer price index will be added each year.
		Value.................	3.75 pct	Carbon dioxide.
	Oil and gas privilege.......	......do..............	2.55 pct	Royalties paid to the United States, State, and Indian interests exempted as are transportation costs and products taxed under occupational gross income tax. Also on carbon dioxide.
	Natural gas processors......	......do..............	0.45 pct	Includes other hydrocarbons. Defines specific processors.
	Oil and gas conservation....	......do..............	0.19 pct	May be raised or lowered depending on amount in conservation fund.
	Oil and gas ad valorem production.	......do..............	Rate certified to Oil and Gas Accounting Commission.	Local ad valorem rate is applied to assessed valuation less certain deductions. In lieu of all other ad valorem taxes on oil interests except equipment.
North Carolina.	Oil and gas conservation....	Per 1,000 cu ft......	0.0005	Fee of $50 for each well drilled, $15 for each well abandoned.
North Dakota...	Oil and gas production......	Gross value..........	5 pct	In lieu of State and local property taxes. Includes royalty interests.
Ohio............	Resource severance..........	Per 1,000 cu ft......	$0.01	
Oklahoma.......	Oil, gas, and mineral gross production.	Gross value..........	7.085 pct	Casinghead gas included. Adjustment for low-producing wells.
	Natural gas and casinghead gas conservation excise.	Per 1,000 cu ft......	$0.07	7 pct of gross value of each 1,000 cu ft is deductible from tax. Tax rate not to exceed 0.333 of gross value of each 1,000 cu ft.
South Dakota...	Energy minerals severance...	Taxable value........	4.5 pct	In lieu of all other mineral taxes except sales, use, and property taxes.
Tennessee......	Oil and gas severance.......	Sales price...........	1.5 pct	Gas used in production exempted. Drilling for $50.
Texas...........	Natural gas production......	Market value.........	7.5 pct	
Utah............	Mining occupation...........	Gross value..........	2 pct	Annual exemption of $50,000 in gross value for each well.
	Oil and gas conservation....	Market value.........	0.15 pct	Not to exceed 0.2 pct. United States, State, and Indian interests exempted.
Wyoming........	Mining excise and severance.	Gross value..........	6 pct	In lieu of tax on land.
	Oil and gas production......	......do..............	0.03 pct	Not to exceed 0.8 pct. United States, State, and Indian interests exempted.

TABLE 12. - Mineral severance taxes--rates, bases, other features--coal

State	Tax	Base	Rate	Other features
Alabama........	Coal severance..............	Per ton..............	$0.135	
	Coal and lignite severance..	.....do..............	$0.20	In addition to Coal Severance Tax and $0.50 per ton Coal Severance Tax levied in De Kalb and Jackson Counties.
Arkansas.......	Natural resources severance.	.....do..............	$0.02	Coal and lignite. In lieu of all other privilege or excise taxes.
Colorado.......	Severance....................	Per ton (surface)....	$0.60	Rate changes 1 pct for every 3-point change in the wholesale price index; 8,000 tons per quarter exempted; 50 pct credit for lignitic coal and for coal produced underground. Credit allowed for contribution to local governments.
		Per ton (underground)	$0.30	
Kentucky.......	Coal severance..............	Gross value..........	4.5 pct	Minimum tax $0.50 per ton.
Louisiana......	Natural resources severance.	Per ton..............	$0.10	
Montana........	Coal severance..............	Per ton or value (whichever is greater).		Applies to production over 20,000 tons per year on the basis of Btu/lb heating quality of coal and whether mined by surface or underground techniques. Tax is on per ton or a value basis, whichever yields the greater amount of tax. Value means contract sales price. Strip or underground mining permit, $50 for 5-year period. Annual prospecting per unit, $100.
		Btu/lb--	Surface--	
		Under 7,000..........	$0.12 or 20 pct	
		7,000-8,000..........	$0.22 or 30 pct	
		8,000-9,000..........	$0.34 or 30 pct	
		Over 9,000...........	$0.40 or 30 pct	
		Btu/lb--	Underground--	
		Under 7,000..........	$0.05 or 3 pct	
		7,000-8,000..........	$0.08 or 4 pct	
		8,000-9,000..........	$0.10 or 4 pct	
		Over 9,000...........	$0.12 or 4 pct	
	Mineral mining.............	Gross value..........	0.5 pct	Applies to gross value over $5,000, plus fee of $25.

New Mexico	Resource excise	do	0.75 pct	Imposed as a resources, processors, or service tax.
	Severance	Per ton	$0.38	Steam coal.
		do	$0.826	Coal severance tax, $0.57 plus surtax, $0.256.
	Oil and gas conservation	Value	0.19 pct	Royalty payments to the United States, State, and Indian interests exempted. Rate may be raised or lowered depending on amount in conservation fund. Some expenses deductible.
North Dakota	Coal severance	Per ton	$0.85	Tax may be increased $0.01 per ton for every 4-point increase in the wholesale price index. Coal used for heating building in State is exempt.
Ohio	Resource severance	do	$0.04	
	Coal excise	do		Applies to any consumer using more than 200 tons per year for generating steam or electric power. Tax based on sulfur content of coal delivered. Tax adjusted for processing to remove sulfur.
		Sulfur content—		
		Minus 0.5 pct	$0.40	
		0.5-1.0 pct	$0.35	
		1.0-1.5 pct	$0.30	
		1.5 pct plus	$0.15	
South Dakota	Energy minerals severance	Taxable value	4.5 pct	Coal, lignite. In lieu of all other mineral taxes except sales, use, and property taxes.
Tennessee	Coal severance	Per ton	$0.20	Following approval of Tennessee's coal surface mining program, rate will be $0.29 per ton for first year, $0.32 per ton for second year, $0.35 thereafter.
Wyoming	Mining excise and severance	Gross value	10.5 pct	In lieu of taxes on land. Portions of tax effective only until certain revenue levels are reached.

TABLE 13. - Mineral severance taxes--rates, bases, other features--metals

State	Tax	Base	Rate	Other features
Alabama........	Iron ore mining...............	Per ton.................	$0.03	Iron ore.
Arkansas.......	Natural resources severance.	.....do.................	$0.15	Barite, bauxite, titanium ore, manganese and manganese ores, zinc ore, cinnabar, and lead ore.
			$0.02	Iron ore.
				No other privilege or excise tax on natural resources.
Colorado.......	Severance...................	Gross income............	2.25 pct	All metals except molybdenum. On gross income exceeding $11 million only. Credit allowed for ad valorem assessed, not to exceed 50 pct of Severance Tax. Credit allowed for contribution to local governments.
		Per ton.................	$0.15	Molybdenum ore.
Florida........	Solid minerals..............	Market value............	5 pct	Includes rare earths.
Idaho..........	Ore severance...............	Net value...............	2 pct	All ores.
Kentucky.......	Natural resources severance.	Gross value.............	4.5 pct	
Louisiana......	.....do.....................	Per ton.................	$0.10	All ores.
Minnesota......	Iron severance..............	Net value...............	15.5 pct	All ores except taconite, semitaconite, and iron sulfides.
		.....do.................	15 pct	Taconite, semitaconite, and iron sulfides. Credits for underground mining, beneficiation, pollution control.
	Ore royalty.................			Applies same rates as Iron Severance Tax to all royalties.
	Taconite, iron sulfides, and agglomerates.	Per ton.................	$1.25	Taconite and iron sulfides. Tax is indexed to steel production but not less than $1.25 per ton. Tax is in addition to Iron Severance Tax and Ore Royalty Tax, but in lieu of all other taxes; 1.6 pct of total tax per ton added for each 1 pct over 62 pct iron content.
			$0.05	Agglomerates.
		.....do.................	$0.10	An additional tax imposed on tailings not disposed of in accordance with permits. A tax of up to $10 per acre is levied on certain reserve lands.
	Semitaconite................	.....do.................	$0.10	Tax is $0.05 per ton if agglomerated or sintered in Minnesota. Add $0.001 per ton for each 1 pct of iron content above 55 pct. Tax is in addition to Iron Severance Tax and Ore Royalty Tax, but in lieu of all other taxes. A tax of $1 per acre is levied on certain reserve lands.
	Copper-nickel...............	Net value...............	1 pct	Occupational tax of 1 pct of value and an additional mining, quarrying, and production tax of $0.025 per gross ton. Additional tax for higher grade ores. Certain expenses deductible from value. Tax on royalties is 1 pct plus an additional 1 pct of royalties paid on gold, silver, platinum, and other precious metals. In addition to other taxes, but in lieu of Iron Severance Tax.
		Per gross ton...........	$0.025	

Montana........	Metalliferous mines license.	Gross value--		All metals and precious and semiprecious stones.
		Up to $100,000..........	0.15 pct	
		$100,000-$250,000.......	0.575 pct	
		$250,000-$400,000.......	0.86 pct	
		$400,000-$500,000.......	1.15 pct	
		Over $500,000...........	1.438 pct	
	Mineral mining..............	Gross value.............	0.5 pct	$25 plus 0.5 pct on gross value over $5,000.
Nevada.........	Net proceeds of mines.......	Net proceeds............	Local property tax rate.	Applies local property tax rate to net proceeds of all mines in State.
New Mexico.....	Resources excise............	Gross value.............	0.75 pct	All metals except molybdenum. Imposed as a resources, processors, or service tax.
			0.125 pct	Molybdenum.
	Severance...................	Value...................	0.5 pct	Copper. Some production expenses deductible.
		Per pound...............	2 pct min. to $3.15 plus 12.5 pct max.	Uranium. Rate varies with value of U_3O_8. For example, if value if $25 to $30 per pound, tax is $1.55 per pound plus 10 pct of excess over $25. From 7-1-81 to 6-30-84, taxable value is 60 pct of sales price. Limited credits allowed. Radiation Protection Continued Care Fund, $0.10 per pound, until fund reaches $1 million.
			0.125 pct	Thorium, rare earth metals, gold, silver, lead, zinc, molybdenum, manganese, and all other metals. Gross value is defined for various commodities.
Oklahoma.......	Oil and gas conservation....	Value...................	0.19 pct	Uranium. Value is 25 pct of resources excise value.
	Oil, gas, and mineral gross production.	Gross value.............	0.75 pct	Lead, zinc, jack, gold, silver, and copper.
		.....do.................	5 pct	Uranium.
South Dakota...	Energy minerals severance...	Taxable value...........	4.5 pct	Uranium, thorium. In lieu of all other mineral taxes except sales, use, and property taxes.
	Precious metals severance...	Gross yield.............	6 pct	Gold, silver. Applies to producer of more than 1,000 ounces.
Tennessee (local option)	Privilege tax on nuclear materials.	Separative work unit.	$0.30	Each county may impose tax for every separative work unit expended within county.
			$1.00	Each municipality may impose tax for every separative work unit expended within a municipality.
Utah...........	Mining occupation...........	Gross value.............	1 pct	Gold, silver, copper, lead, iron, zinc, tungsten, uranium, and other valuable metals; $50,000 exemption each mine.
Washington.....	Uranium and thorium milling.	Per pound...............	$0.05	
Wisconsin......	Metalliferous minerals occupation.	Average net proceeds....		Metalliferous minerals. Average net proceeds is based on preceding 3 years. Deductions allowable to reach net proceeds are specified.
		$100,000-$4 million.....	6 pct	
		$4 million-$10 million..	12 pct	
		$10 million-$20 million.	16 pct	
		$20 million-$30 million.	18 pct	
		Over $30 million........	20 pct	
Wyoming.......	Mining excise and severance.	Gross value.............	2 pct	Any valuable deposit. In lieu of taxes on the land.
		.....do.................	5.5 pct	Uranium. Portion of tax effective only until certain revenue limits are reached.

TABLE 14. - Mineral severance taxes--rates, bases, other features--nonmetals

State	Tax	Base	Rate	Other features
Alabama (Bibb, Elmore Counties).		Per ton..............	$0.01-$0.05	No State severance tax. Bibb County, $0.05 per ton of stone. Elmore County, $0.01 per ton of clay, sand and gravel.
Arkansas.......	Natural resources severance.	.....do..............	$0.01	Crushed stone, including chert, granite, slate, novaculite, limestone, construction sand, gravel, clay, chalk, shale, and marl.
		.....do..............	$0.015	Gypsum (sold for out-of-State use) chemical grade, limestone, silica sand, and dimension stone.
		Per 1,000 bbl........	$2	Salt water used as raw material for bromine.
		Market value.........	5 pct	Diamonds, fuller's earth, ochre, natural asphalt, native sulfur, salt, pearls, other precious stones, whetstone, novaculite, and all other natural resources.
Colorado.......	Severance..................	Gross proceeds.......	4 pct	Oil shale, Graduated to 4 pct or fourth year after production reaches 50 pct of design capacity; first 15,000 tons or 10,000 bbl per day exempted; 25 pct credit for in situ methods. Credit allowed for contribution to local governments.
Florida........	Solid minerals.............	Market value.........	5 pct	Includes clay, gravel, lime, shells (excluding live shellfish), stone, sand, and rare earths. Limited credit allowed for ad valorem taxes paid on property. No tax on minerals extracted to improve site upon which Florida sales tax is paid or which is sold to government agencies in Flordia. Refund allowable for reclamation program.
Idaho..........	Ore severance..............	Net value............	10 pct	Phosphate rock.
			2 pct	All ores.
Kentucky.......	Natural resources severance.	Gross value..........	4.5 pct	Excludes processing of ball clay; rock, limestone, or gravel used for privately maintained but publicly dedicated roads; limestone used for agricultural purposes.
Louisiana......	.....do....................	Per ton..............	$0.03	Sand and gravel and stone.
		.....do..............	$0.06	Salt.
		.....do..............	$0.005	Salt from brine used in manufacturing.
		.....do..............	$0.04	Shells.
		.....do..............	$0.10	Ores.
		.....do..............	$0.20	Marble.
		Per long ton.........	$1.03	Sulfur.

Minnesota......	Local gravel production tax.	Per cubic yard.......	$0.10	Counties are authorized to impose tax not to exceed $0.10 on removal of gravel for sale from gravel pits.
Mississippi....,	Salt severance..............	Value................	3 pct	Salt. Applies to salt produced from soil or water.
Montana........	Micaceous minerals license..	Per ton..............	$0.05	Vermiculite, perlite, kerrite, maconite, or any other micaceous minerals.
	Cement license..............	.....do..............	$0.22	Cement.
		.....do..............	$0.05	Cement, plaster, gypsum, and gypsum products.
	Mineral mining..............	Gross value..........	0.5 pct	All minerals; $25 plus 0.5 pct on gross value over $5,000.
Nevada.........	Net proceeds of mines.......	Net proceeds.........	Local property tax rate.	Applies local property tax to net proceeds of all mines in State.
New Mexico.....	Resources excise............	Gross value..........	0.75 pct	All taxable nonmetals (except potash). Imposed as a resources, processor, or service tax.
		.....do..............	0.5 pct	Potash (if taxed under Resources Tax; 0.125 pct if under Processors Tax).
	Severance...................	.....do..............	2.5 pct	Potash. Gross value defines as 0.333 pct of proceeds less deduction for expenses.
		.....do..............	0.125 pct	Clay, gravel, gypsum, sand, fluorspar, pumice, and all other nonmetals. Gross value defined for individual commodities.
Ohio...........	Resource severance..........	Per ton..............	$0.01	Limestone, dolomite, and sand and gravel.
		.....do..............	$0.04	Salt.
Oklahoma.......	Oil, gas, and mineral gross production.	Gross value..........	0.75 pct	Asphalt.
Texas..........	Cement distributors.........	Per 100 lb...........	$0.0275	
	Sulfur production...........	Per long ton.........	$1.03	
Wyoming........	Mining excise and severance.	Gross value..........	2 pct	Any valuable deposits (except trona and oil shale).
			5.5 pct	Trona.
			4 pct	Oil shale.

Source: Commerce Clearing House, Inc. State Tax Guide: All States, New York, Chicago, and Washington, 1967 (with updated supplements to August 19[illegible]).

PREPARED STATEMENT OF DONALD FRAZER, MAYOR OF MINNEAPOLIS, MINN.

Senator Durenberger and other distinguished members of the Subcommittee, I am pleased to submit testimony on an issue which is of significant concern to me -- the growing severance tax revenues on exported energy resources which threaten potential impoverishment for the older cities of the Northeast and Midwest. I am particularly concerned about one aspect of that problem: the enormous severance taxes on coal now levied by two states, Montana and Wyoming, who now tax coal at 30% and 17.5% respectively. I am concerned first as Mayor of Minneapolis, one of the major cities of Minnesota, which gets nearly all of its coal from Montana. I am also concerned, however, as a citizen of the United States, because I believe that the parochial and unprecedented actions of the western coal states in increasing their taxes to exploit unusual market power threaten fearsome consequences for the whole nation.

For that reason, my testimony today is given both as an elected official of the City of Minneapolis and as Chairman of the National Coal Consumers Alliance Steering Committee. The Steering Committee is a group of public officials who, on behalf of the citizens of their states, have endorsed and actively supported your bill, S. 178, its House counterpart, H.R. 1313, and predecessor bills in the 96th Congress -- all legislation which would restrain these needlessly excessive coal tax rates to the reasonable level of 12.5%. The other members of the Steering Committee include elected officials from states including Minnesota, Michigan, Texas, Iowa, and Illinois, to name only a few.

The National Coal Consumers Alliance and its allies in this legislative effort comprise a broad coalition of public figures, public and private utilities, consumer groups, national and local associations, and others who advocate restraint of excessive and unfair coal severance taxes. Detroit Edison, Northern States Power Company, Commonwealth Edison, the Consumer Federation of America, Americans for Energy Independence, the American Public Power Association, the National Rural Electric Cooperative Association, the Arkansas Electric Cooperative Corporation, the U.S. Conference of Mayors, and several of the state utility regulatory commissions are among the supporters of this legislation.

As you can see, the proponents of this legislation are many and varied and represent a broad base of support. And so it should be, since today 21 states are directly affected by the excessive coal severance tax rates imposed by just two states -- Wyoming and Montana, who collected a total of approximately $171.2 million in coal taxes last year, 90% of that from out-of-state consumers. By 1987, 27 states will be affected, paying an estimated $360 million annually in coal taxes to Montana and

Wyoming. I mention both the broad support and the extensive impact because the only opponents of remedial legislation seem to be the elected local, state and national officials of the very two states whose unfair tax policies have created this national problem.

Because of my concern over this issue, I introduced a strongly-worded resolution at the U.S. Conference of Mayors' 48th Annual Meeting in Seattle, Washington, in June of last year, asking the Mayors of this country to join forces in support of Federal legislation to place a reasonable limit on coal severance taxes. I am pleased to say that my Resolution --- Resolution No. 31 --- was approved decisively by the U.S. Conference of Mayors in 1980 and remains an ongoing element of the Conference's legislative agenda. Specifically, Paragraphs 10 and 11 Resolution 31 provide as follows:

> 10) NOW, THEREFORE, BE IT RESOLVED that the U.S. Conference of Mayors supports federal legislation to place a reasonable limit on coal severance taxes which may be imposed by states, and that the Conference does further urge members of Congress to take expeditious action on pending legislation to provide such vitally needed tax relief to our nation's energy consumers.
>
> 11) BE IT FURTHER RESOLVED that the U.S. Conference of Mayors urges that coal severance taxes which are levied should be expended to mitigate the impacts of coal mining.

I would also like to emphasize that we found broad geographic and non-partisan support among the Mayors of this country for Resolution 31, including Mayors from Yuma, Arizona, Little Rock, Arkansas, San Bernardino, California, Atlanta, Georgia, Gary, Indiana, Indianapolis, Indiana, Houston, Texas, Rockville, Maryland, Omaha, Nebraska, Newark, New Jersey, and Columbus, Ohio. Several of those I just listed represent states which are not directly affected by the excessive coal tax rates of Montana and Wyoming but objected on principle to the unfair taxing practices of these states and the national consequences they fear from this tax profiteering. What my fellow Mayors and I fear is an economic Balkanization of this country. Energy-producing states, lured by the success of Montana and Wyoming at reaping immense profits from exported taxes, are beginning to consider similar tax increases. Energy-consuming states are beginning to consider retaliation in the form of taxes on commodities they export. Such a result would be chaotic and intolerable. It must be averted before the situation becomes unmanageable.

This potential national situation, fortunately, is not here yet -- although it surely will be if Congress does not respond. My own state, however, is a hard-hit victim of excessive severance taxes today. As I mentioned, we in Minnesota are particularly burdened by Montana's 30% severance tax, since the vast majority of the western coal purchased by Minnesota utilities comes from that state. In 1980, three major Minnesota utilities purchased western coal: Minnesota Power and Light Company, the Northern States Power Company, and the upper Peninsula Generating Company. Together they paid an estimated $20.5 million in coal severance taxes to the state of Montana. These taxes are passed directly on to consumers through fuel adjustment clauses.

Due to increased demand for western coal, principally by Minnesota Power and Light and Northern States Power Company, the severance taxes paid by Minnesota consumers, assuming no changes in the current tax levels and based on 1979 dollars, will increase significantly in the next ten years. That means that by 1992 Minnesotans will be paying Montana around $38 million each year in coal severance taxes alone.

I feel strongly that this tax burden on the citizens of my city and my state is grossly unfair. The 17.5% tax level imposed by Wyoming and the 30% level imposed by Montana are many times in excess of present and future impact costs of coal production. Thus, they contribute directly to inflation without economic justification. At a time when the Administration has declared an all-out war on inflation, such economically unjustified tax burdens cannot be tolerated.

The 30% tax imposed by Montana was enacted only after Federal environmental and coal conversion policies heralded a boom in the low-suplhur coal found in great abundance in Montana and Wyoming. With almost 70% of the low-sulphur coal deposits in this country, these two states hold a near-monopoly over its production. It seems to me that they are exploiting this commanding market position and our national policies at the expense of energy consumers in Minneapolis, in Minnesota, and in what will shortly be 27 states.

I do not mean to suggest that a State should not have the power to levy severance taxes on its natural resources. We in Minneapolis, in Minnesota and in the 27 states that will soon be consuming electricity generated from western coal seek only to limit the excessive nature of these taxes to reasonable levels. And it must not be forgotten that the majority of the coal in Montana and Wyoming is Federal coal, which, while bringing the producing states substantial Federal revenues in leasing royalty rebates and impact aid, belongs to all the citizens of this country and should be taxed in a way that is fair to all of them. Most importantly, two states should not be permitted to incite a resource-taxation war with potentially devasting consequences for consuming states and the economy of the entire nation.

The United American Emirates

State Revenues From Non-Renewable Energy Resources

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Northeast-Midwest Institute
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INTRODUCTION

National resource policy problems will continue to be among the pivotal issues facing our nation during the 1980s and 1990s. Over the past eight years the U.S. has tried to come to grips with the world liquid fuel crisis through a variety of policy responses. For example, just recently President Reagan removed all price controls on oil, ending the phased decontrol of domestic crude oil prices and producing a substantial adverse domestic economic shock. These kinds of decisions have been forced by a world energy market monopolized by a political entity, the Organization of Petroleum Exporting Countries (OPEC). The new energy economics confronting the nation requires that the market price of energy approximate the replacement value of the consumed product. This painful short-term path is necessary both to avoid a more difficult transition to world prices as domestic sources are exhausted and to encourage domestic production of energy.

The domestic economic repurcussions of energy price decontrol are difficult to predict with precision, but it is apparent that the regional effects will be profound. Energy consuming regions of the nation will be faced with the negative consequences of price decontrol. Individuals and firms in these regions will pay higher costs for energy without directly receiving the benefits of production-related economic activity. In a paper published in April 1980, the Northeast-Midwest Institute introduced a second and largely unanticipated result of decontrol: the "windfall" of vastly increased revenues flowing to major oil producing states as a result of ad valorum state energy severance taxes, royalties, and other fees. These revenues will produce surpluses for the governments of energy producing states and an outflow of capital from the energy consuming regions. Energy-poor states, faced with escalating energy prices and unable to benefit directly from the production-related benefits of decontrol, also will find some of their tax revenues declining. This unanticipated result of price decontrol will increase the regional disparity in growth rates that currently is "unbalancing" our national economy.

BACKGROUND

One has only to look North from the "lower forty-eight" and East from Alaska to witness a set of serious energy-related tensions threatening the Canadian federal system. These tensions are developing rapidly in our own country as well. The parallels are too strong to ignore. For example:

- In both countries, a small number of states (or provinces), with a relatively small share of the nation's population, control most of the nation's domestic energy resources or production (see Table 1).
- In both countries, the major producing states (or provinces) are endeavoring to reap the greatest possible economic or fiscal advantage from their positions as net energy exporters, although by somewhat different methods.
- In both countries, the energy consuming states (or provinces) are more heavily industrialized and older than the energy producing states -- and in both countries the older manufacturing regions are suffering problems of economic stagnation.
- Finally, in both countries, polarization between what the National Journal has called the energy "winners" and "losers" has been growing rapidly.

U.S. Situation

In the United States, a strong contributing factor to new energy tensions will be the extraordinary increase in severance tax and royalty revenues derived from the extraction of oil, gas, and coal during the era of domestic price decontrol.

Table 1 shows that in the U.S. nine states are major exporters of conventional energy commodities. This table ranks states by their exporting position and reveals that there is no "generally accepted" level of severance taxation. Oil is taxed at rates ranging from 12.5 percent to 1.5 percent, gas at rates ranging from 10 percent to zero, and coal at rates ranging from 30 percent to zero.

TABLE 1

Energy Surplus States By Rank[1]
and Tax Rates (percent of value)[2] -- 1978

Exporting Rank[1]	Oil Percent	Gas Percent	Coal Percent
1. Louisiana	12.5	3.5[2]	0.2
2. Wyoming	4.0	4.0	10.5
3. New Mexico	7.0	5.8	8.4
4. Kentucky	1.5	n/a	4.5
5. Alaska	12.25	10.0	n/a
6. Oklahoma	7.0	7.0	0.3
7. West Virginia	4.35	8.63	3.5
8. Montana	2.1-2.65	2.65	30.5
9. Texas	4.6	7.5	n/a

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[1] Chase Econometrics, cited by Richard Corrigan and Rochelle L. Stanfield, "Rising Energy Prices -- What's Good For Some States Is Bad For Others," National Journal, March 22, 1980, p. 469.

[2] Calculated by Harley T. Duncan, Staff Associate, National Governors Association, March 6, 1980. From U.S. Department of Commerce, Bureau of the Census, State Government Tax Collections in 1978, January 1979.

The revenues derived from the taxation of non-renewable energy resource extraction vary dramatically from state to state, as shown in Table 2.

TABLE 2

Severance Taxes as a Percentage of State Revenues -- 1978

State	Percent
Louisiana	23.55
Wyoming	22.81
New Mexico	19.16
Kentucky	6.96
Alaska	19.13
Oklahoma	17.51
West Virginia	13.99*
Montana	11.95
Texas	17.68

SOURCES: Calculated from U.S. Department of Commerce, Bureau of the Census, State Government Tax Collections in 1978, January 1979, and *state-supplied data.

In several of these states, energy-related royalties and other fees also are very substantial, and adding these revenues to severance tax revenues produces even higher rates of dependence on non-renewable energy for the payment of state government expenses. The reliance upon revenues from energy non-renewables by these states enables them to use other taxes less intensely or not at all (e.g., Texas has no personal or corporate income taxes).

Oil and gas severance tax revenues already had grown substantially since the Arab oil embargo; there was almost a three-fold increase in these revenues from $710 million in 1972 to over $2 billion in 1978.[1] However, the increases expected between 1980 and 1990 -- the era of domestic decontrol -- will dwarf anything we have seen so far. The Treasury Department estimated in 1979 that all state and local revenue increases in this decade as the result of oil price decontrol alone will add up to more than $127 billion.[2] According to this estimate, 90 percent of the total will be concentrated in the eight major oil producing states.

The oil price assumptions underlying the Treasury Department projections are now seen as quite conservative. No reliable estimates have yet been made concerning revenue increases resulting from the phased decontrol of natural gas. However, one reliable analyst predicts that the figure will be about $50 billion -- and this would be in addition to the $127 billion increase resulting from oil price decontrol. It must be emphasized that these are unsophisticated estimates made more than a year ago with econometric modeling techniques that didn't distinguish between severance taxes, royalty, and other forms of revenue. The Institute is now completing its projections oil and gas severance tax and royalty receipts for major producing states. Under existing law these receipts will exceed $220 billion during the 1980s, according to our prelimary estimates.

Information newly available from one major producing state is illustrative. Alaska is the only state that has rigorously projected oil severance tax and royalty revenues into the future. Table 3 shows that estimates for oil revenues made by Alaska's Petroleum Revenue Division approach $200 billion over the next 20 years. It should be noted that these estimates relate only to proven reserves at Prudhoe Bay, yet a strong possibility exists that additional fields will be opened during this period in such areas as the Beaufort Sea. Alaska currently has a population of approximately 400,000 -- less than the average individual U.S. congressional district.

State revenues such as these are only a part of the extraordinary surplus value that OPEC monopoly power has created in the oil industry. With OPEC control over prices and supplies, the "market" in oil is destroyed, with resulting "windfalls" flowing to all parties engaged in oil production, or in the taxation of that production. The taxation of domestic production -- sold at OPEC world prices -- produces a "windfall" of economic rent for the domestic producing state. Economic rent can be considered that portion of the surplus value of a commodity that the state taxes away for its own purposes. This assertion of sovereignty by producer states over these natural resources, combined with domestic decontrol of oil prices, has created a de facto "United American Emirates," a group of oil producing states whose projected growth in oil-related revenues is threatening to precipitate one of the largest capital transfers in our nation's history.

TABLE 3

ALASKA REVENUE ESTIMATES, BY SOURCE
($ Millions)

Fiscal Year	Royalties	Severance	Property Tax	Oil Company Income Tax	Non-Petroleum Revenue
1981	$1,502.4	$1,183.5	$170.0	$770.0	$200.0
1982	2,354.9	1,753.3	170.0	882.9	222.2
1983	2,924.4	2,140.4	198.2	1,013.8	246.9
1984	3,431.1	2,416.8	225.3	1,165.7	274.7
1985	4,003.4	2,816.2	248.9	1,333.1	304.7
1986	4,451.8	3,130.8	271.3	1,469.1	338.5
1987	4,955.5	3,483.9	271.8	1,635.3	376.1
1988	5,482.7	3,856.7	271.4	1,809.3	417.9
1989	5,969.5	4,238.9	270.2	1,969.9	464.2
1990	6,208.5	4,418.4	267.8	2,048.8	515.8
1991	6,264.1	4,446.7	259.1	2,067.2	573.0
1992	5,976.9	4,189.0	249.5	1,972.4	636.6
1993	5,713.6	3,954.4	239.3	1,885.5	707.3
1994	5,281.5	3,581.0	228.1	1,742.9	785.8
1995	4,905.9	3,252.7	216.3	1,618.9	873.0
1996	4,595.6	2,981.0	203.7	1,516.5	969.9
1997	4,302.7	2,731.5	190.3	1,419.9	1,077.6
1998	4,029.0	2,503.6	175.9	1,329.6	1,197.2
1999	3,773.3	2,295.0	160.8	1,245.2	1,330.1
2000	3,534.2	2,104.3	144.8	1,166.3	1,477.7

These estimates do not include any natural gas or coal revenues.

SOURCE: Alaska Department of Revenue, Petroleum Revenue Division, Revenue Forecast Quarterly Report, September 1980.

Canadian Comparison

In Canada, Alberta is the producer of 85 percent of the nation's oil and 90 percent of its natural gas. This province has received large increases in energy-related tax and royalty revenues since the 1973 OPEC embargo. The Alberta Heritage Savings Trust Fund, with a current balance of $6 billion dollars, is projected to grow to $25 billion by the end of the decade.[3] This will occur despite the retention by Canada's central government of price controls on domestic oil sales.

The Canadian response to the OPEC monopoly has been markedly different from that of the United States. The National Energy Plan (NEP) proposed by the Trudeau regime is a dramatic, controversial, and nationalistic program. It proposes a Canadianization of the domestic oil and gas industry, a large increase in federal revenues from oil and gas production, several new institutional programs to govern development and control the regional impacts of higher energy prices, and a decrease in provincial revenues and control over natural resources.

Albertan opposition to the Trudeau plan has been dramatic. Premier Peter Lougheed recently announced a 15 percent reduction in oil production over the next nine months as retaliation for the NEP. He also has stated that Alberta will fight the NEP in the courts.

Alberta is not alone in opposing portions of the NEP. Newfoundland has laid claim to outer continental shelf areas in defiance of Ottawa. British Columbia has expressed extreme displeasure at the proposed natural gas tax contained within the NEP.

The issues in Canada and the U.S. discussed above deal with revenue increases resulting from energy taxation in producing states or provinces. However, there is an opposite effect of energy price decontrol as well.

Decontrol Impact on Energy-Poor Regions

No reliable estimates have been made concerning the various revenue decreases the energy importing states will suffer as the result of energy price decontrol, except in the area of motor fuel taxes. For example, how will the corporate income taxes of energy importing states be affected by the higher costs of energy? Our guess is that there will be substantial reductions with respect to firms that buy a significant amount of energy. Already enormous cash outflows from such firms to energy producing firms are developing, but the state revenue effects of this shift have not been projected. However, it is reasonable to assume that state government budgets in energy consuming states will be worse off.

The Energy Action Educational Foundation has focused on the regional impact of natural gas decontrol on the American economy. A February 1981 report by the foundation stated that "natural gas decontrol alone will accelerate the decline of the Northeast and the Midwest, and will overwhelm any action by either the federal government or the states to prevent the erosion of the country's northern industrial base."[4]

The foundation estimates that immediate decontrol of natural gas would drain $275 billion from the economies of 16 Northern states between 1981 and 1985, and it goes on to estimate that the Texas, Louisiana, Oklahoma, and New Mexico economies will receive $493 billion in private and public benefits between 1981 and 1985 if gas decontrol is immediate. These tremendous sums of money include a dramatic increase in state receipts from natural gas taxation. Although no detailed projections have been done of the increase in isolated state severance tax and royalty income that would occur under accelerated or immediate decontrol of natural gas, our preliminary estimates indicate that under existing law the increase will exceed $50 billion and could approach $90 billion with immediate decontrol.

Pending Legislation

A good deal of attention is being paid by federal lawmakers to coal severance taxes. This attention is due in part to the well-organized lobbying efforts of some of the nation's electric utilities. Several members of the 96th Congress introduced bills with many cosponsors to limit such taxes to 12.5 percent, and one of these bills actually was ready for floor action on the House side when the session closed. In the current Congress, S. 178 would limit severance taxation of coal production from federal and Indian land to 12.5 percent. H.R. 1313 would do the same for all coal destined for interstate commerce. There is enormous variation in coal severance tax rates around the country, with western coal generally taxed at high rates -- Montana is at the top of the scale -- and eastern coal taxed at low rates or not taxed at all (see Table 1).

Pending Litigation

Two Supreme Court cases regarding state severance taxation bear significant implications for energy producing states' financial systems, and may alter the regional economic disparities we project if no legal or legislative interventions occur. A decision in Commonwealth Edison, et. al. v. The State of Montana, et. al., Supreme Court 80-581, could either require a "testing" of existing severance taxes through a District Court trial or other evidentiary proceeding to determine whether or not they are valid under the commerce clause, or alternatively allow existing severance tax rates to be dramatically increased without recourse for consuming states. The State of Maryland, et. al. v. The State of Louisiana, Original No. 83, was decided in favor of the plantiffs on May 26, 1981. That 7-1 decision ruled the Louisiana "first-use" tax unconstitutional as it currently exists.

Commonwealth Edison, et. al. have challenged the imposition of a 30 percent coal severance tax by Montana. It is applied to coal produced from federal leases, and the intergovernmental as well as interstate commerce implications of a 30 percent tax are highly significant when the "natural resource lands" are concerned. This case has produced substantial questions of law and numerous interests have filed briefs. The major points of law at issue are:

- whether or not a state severance tax that burdens interstate commerce is subject to commerce clause scrutiny;
- whether or not the rate and amount of a tax can justify its being ruled invalid under the supremacy clause because it is inconsistent with the Mineral Lands Leasing Act of 1920;
- whether or not the rate and amount of a tax can justify its being ruled invalid under the supremacy clause because it frustrates "national energy policy" designed by the Congress; and
- whether or not a state tax substantially paid by out-of-state interests violates the Constitution's commerce clause because the revenues exceed the financial requirements of the state to mitigate the impacts of the industry.

This case -- and the numerous arguments advanced by the opposing parties -- raises serious questions regarding the nation's non-renewable energy resource taxation policies.

The plaintiffs and their supporters argue that the wealth gap created by OPEC monopoly power, decontrol, state energy levies, and the uneven geographic distribution of non-renewable energy reserves has ominous implications for energy importing regions. With domestic oil prices the same as OPEC-determined world prices, market value-related state severance taxation reaps monopoly level revenues. This extraordinary tax burden may produce divisive and recriminatory state actions that would severely threaten interstate commerce. For example, recently enacted and under litigation now are gross receipts taxes applied by New York and Connecticut to oil corporations.

Neither party disputes the fact that Montana "exports" approximately 86 percent of its coal severance tax burden and under federal law receives 90 percent of the economic rent demanded by the federal government in the form of royalty sharing and reclamation fund transfers. The central question at issue in the case is whether or not a 30 percent severance tax on production, including that from federal land, is justified or constitutes a burden on interstate commerce.

Available precedent appears at first blush to support the defendents. Heisler v. Thomas Colliery, 260 U.S. 245 (1922), a case whose foundation was laid in the 1880s in Coe v. Errol, 116 U.S. (1886), forms the basis for the lower court decisions being appealed. Relying on Heisler, which found that mining was a purely local concern and that the existence of a "natural monopoly" had no effect on interstate commerce, the lower courts denied the motions of the plaintiffs for a trial. The narrow reliance on this 60-year-old precedent would allow energy exporting states to impose monopoly-type taxation policies that could threaten the economic and social systems of financially strained energy importing regions.

There is little doubt that the commerce clause powers easily can reach state severance taxation and regulate the application or existence of this taxation. Nonetheless, it may be that the Court will find for the defendants and throw the ball into the national legislative court by claiming that no existing statute requires judicial intervention.

The other energy taxation case with somewhat narrower legal implications but large dollar values at stake, Supreme Court Original No. 83, State of Maryland et. al, v. State of Louisiana, challenged the imposition of a "first-use" tax on natural gas extracted from outer continental shelf (OCS) land as it moved through the state on its way north by pipeline. This taxation by Louisiana of gas production from land owned by the federal government was under legal attack by states in the Northeast because it appeared to be an obvious attempt by Louisiana to extract revenue from a clearly discriminatory tax. The Court's invalidation of this tax likely will keep natural gas prices in the Northeast lower than they would have been.

ANALYSIS

Despite all the attention paid to state coal taxes, it is important to keep in mind that the net economic impact of coal severance taxes is much smaller than the impact of either oil or gas taxes and fees. The rates on oil and gas imposed by the states are somewhat more uniform from state to state -- and might appear to be more reasonable (see Table 1). However, because of the massive volumes of oil and gas purchased now and likely to be purchased in the future on the domestic market, the decontrol of domestic prices, and monopoly control of world prices, the impact of oil and gas severance taxes and royalties is much greater than the impact of coal taxes.

Our general concern is that the creation of a kind of "United American Emirates," a group of "superstates" with unprecedented power to beggar their neighbors in the federal system in economic and fiscal terms, will accelerate the decline of energy poor regions and thwart efforts to revitalize the troubled economic structure of the older industrial states.

We have identified at least three separate problem areas of a more specific nature.

- First, these enormous new revenues almost inevitably will lead to powerful new location incentives for people and businesses, accelerating the massive shifts of population to these areas already taking place. In the next several years, one can expect other states to follow Alaska's lead and cut or eliminate more traditional taxes, making them even more attractive places in which to relocate. States that don't have the natural resources to tax won't be able to compete with such tactics, and will lose out.

- A second reason for concern is that several major federal funding formulas will be distorted. Under these formulas, the energy rich states actually could receive larger shares of federal funds -- or continue receiving the same favorable shares they now get -- even though their need for these funds will be much smaller because of the newfound wealth they can tap.

- Third, there is a strong possibility that a dangerously divisive tax warfare will break out, with each state striving to tax a precious commodity just to preserve its competitive position. In fact, this warfare may have begun already; Montana's state legislature passed its huge coal tax increase after strong debate language about the need to keep up with Texas in the severance tax business. In the mid-1970s, Pennsylvania contemplated a severance tax on electricity generated at mine-mouth plants and exported to other states. Connecticut and New York have passed special taxes on oil companies, although these taxes are under question in the courts. New Jersey, Pennsylvania, and other states are looking into a tax on oil refineries. Oregon has a tax on trees, and there is nothing to prevent the imposition of state taxes on other crops. It should not surprise us if agricultural states retaliate against other severance taxes by putting their own taxes on grains used in alcohol fuel production, or perhaps all grains.

In any such warfare, the Northeast and Midwest will be heavy losers -- and so, ultimately, will the entire nation, as its states and perhaps its local governments impose heavy new tax burdens on certain sectors and become dangerously reliant on these narrow and probably regressive tax bases.

The perception in energy consuming states is that the burdens of severance taxes and royalties are "forward-shifted" fully to consumers and, thus, "exported" beyond the borders of the state imposing the tax. Actually, this issue is more complex than most observers in the consuming states have acknowledged. To understand forward-shifting, it must be recognized that OPEC monopoly pricing and domestic decontrol combine to provide windfall revenues to all parties engaged in oil production. With OPEC controlling the world oil market, there is no effective supply and demand mechanism. OPEC controls enough incremental supply capacity to enforce its general price decisions on the entire market. Under decontrol these inflated prices will provide a layer of monopoly revenue returns from which jurisdictions imposing ad valorum taxes will reap corresponding windfalls. This economic rent does not affect price any more than any other cost of production because of the layer of monopoly revenue return already provided by OPEC pricing. However, a capital transfer does occur between energy consumers' pocketbooks and energy producing states' treasuries as oil and oil products are transferred domestically. (See Anthony Scott, Natural Resource Revenue, University of British Columbia Press, Vancouver, British Columbia, 1976.)

The Congressional Research Service (CRS) has calculated that major oil producing states siphon off a substantial share of the rent stream paid by consumers in importing states to energy producing firms, as shown in Table 4.

TABLE 4

State	Oil Severance Tax Revenue 1979	Percentage of Oil Severance Tax Exported
Texas	$1,009,174	64
Louisiana	453,708	79
Oklahoma	244,791	57
Alaska	173,491	85

SOURCE: Congressional Research Service, calculations prepared by Larry Parker at congressional request.

The calculations cited above deal only with crude oil disposition and do not include the severance tax liability found in finished oil-based products. For example, the transfer of refined products ready for consumer use from producer states will carry the severance tax burden applied to the domestic crude from which the final product was made. The exported portion of a severance tax burden carried by these finished products has not been estimated. However, these exported taxes add substantially to the revenues generated through crude oil transfers. In the absence of state severance taxation, royalties, and other fees, the price would remain the same but the windfall revenues all would flow to the producer. The "windfall profits tax" (WPT) and corporate income taxation might reduce the capital accumulation in the oil industry in a regionally equitable fashion because they are national taxes, unlike state-applied severance taxes. Although the Northeast and Midwest regions are in a "deficit" position with respect to the federal taxes they pay and the expenditures they receive in return,[5] corporate income tax and WPT revenues still are spent by the federal government in a regionally more equitable fashion than state severance tax revenues ever can be. However, because the WPT exempts state royalties from taxation and treats severance taxes as business expenses, and because state-by-state severance taxation, royalty, and other policies generate huge revenues, an enormous interregional capital transfer will occur.

The current policy of energy price decontrol assures that consumers will pay the approximate replacement cost for liquid fuels in the near future. However, the Congress, through the enactment of the WPT, has effectively stated that the "price floor" imposed by OPEC will distort the replacement value of energy to such a degree that a WPT and the equitable distribution of its revenues are justified. The federal government allocates its non-renewable energy resource revenues to production of other non-renewable energy commodities -- coal, synfuels, shale oil, etc. -- and to the general fund. The same is true of federal mineral leasing revenues, which are spent on parks, recreation, historical preservation, land and water conservation, and general services. Although these items may deserve support, the use of revenues from an irreplaceable energy resource to do so seems myopic at best. The federal policy in this regard also contrasts sharply with the investment strategy of one energy producing state (see discussion of Alaskan experience below).

We also should recognize that resource depletion is approaching in various other strategic minerals, with no consistent national policy in place. The nation as a whole faces a bewildering array of resource scarcities in the coming decades, in minerals like silver and bauxite, in foodstuffs like fish, and even in the resource taken for granted too long -- water. The economic and national security implications of these scarcity problems demand that we develop institutions or devices that effectively address these concerns. (See Council on Environmental Quality and Department of State, The Global 2000 Report to the President: Entering the Twenty-First Century, U.S. Government Printing Office, 1980.)

These considerations will compell Congress to take action during the next few years despite obvious constitutional objections that may be encountered by any federal intervention in state taxing powers.

POLICY ALTERNATIVES FOR THE CONGRESS

Several federal policies could be adopted to deal with these effects. In addition to doing nothing, the alternatives include the following options, which are not mutually exclusive:

- reforming current royalty arrangements set out in federal law. The current allocation of the economic rent demanded by the federal government would be one question addressed in such an evaluation. Another should be the appropriate level of economic rent. Additionally, the question of how the present leasing of production rights affects the susceptibility of federal resource production to state taxation needs consideration;
- correcting distribution formula distortions, either through some form of omnibus legislation or through amendments to specific authorization bills;
- limiting state severance taxes, royalty fees, and other rates and/or total revenues in some fashion, or outlawing the state levies on non-renewable energy resources altogether; and
- replacing state severance taxes and royalties with a uniform system of national severance taxes and fees, the revenues from which could be shared in some equitable fashion around the nation.

The last option deserves further elaboration, and a useful starting point may be a look at the Alaskan experience. The state government of Alaska has chosen to invest some of its energy revenues in the Alaska Renewable Resources Corporation (ARRC), a large-scale, flexible public development entity charged with taking debt and equity positions in private venture projects designed to reduce the state's dependence on non-renewable energy and other natural resources. This bold experiment could be the single brightest hope for a stable, diverse Alaskan economy of the future, an economy that need not be dependent on finite supplies of fossil fuels.

Other domestic energy producing states also should be concerned about their overdependence on revenues derived from non-renewable energy as a fiscal tool. As a recent GAO report stated, "continued heavy reliance on decreasing resources has caused little concern for diversification planning, perhaps largely because rising energy prices are stimulating the region's economy and generating increased public sector revenues. . . . Through appropriate oversight, the Congress can help assure that potentially severe economic dislocations in the Southwest's basic industry are anticipated in time to take mitigating actions, and thus, to preclude the need for huge Federal aid expenditures in what could become a distressed area."[6] This report's conclusions have ominous implications for those states that import the oil and gas produced by Texas, Louisiana, and Oklahoma.

As noted earlier, present individual state severance taxation, under current market conditions, results in a large capital transfer from energy consuming states to energy exporting states. These effects vastly increase the likelihood of congressional action during the 1980s. But how should the revenues of an equitable, uniform national severance tax be spent?

As a nation, perhaps we should follow Alaska's lead and give consideration to setting up a National Resources and Economic Recovery Corporation, which would incorporate the current but go far beyond the charter of the all-too-narrow

Synthetic Fuels Corporation. A National Resources Corporation could be charged with investing also in the development of a wide range of renewable energy production and conservation technologies, designed to help us deal with a variety of other natural resource scarcities as well. In addition, such a corporation could provide the capital necessary to revitalize basic industrial sectors and assist in the development of world-competitive new industries.

The source of capital for this corporation could be the national uniform severance tax suggested in the final federal policy option noted earlier. Some persons will argue it is not necessary to replace state severance taxes with a national severance tax to finance investments and reindustrialization. The windfall profits tax, estimated to bring in $227 billion over the next ten years, could be the source of the needed revenue. However, while that tax is in place, it seems increasingly clear that its revenues are not going to be reinvested exclusively in making the U.S. energy independent. The Synfuels Corporation -- an enterprise increasingly being questioned in Washington -- may be the only significant use of windfall profits tax revenue for that purpose. Instead, other fiscal pressures are going to determine that WPT revenues be used for general purposes and to balance the budget. President Reagan's newfound willingness to retain the tax is perhaps the clearest signal of this fact. Also, the WPT is only temporary -- its statute will end it within ten years. Yet we need a permanent, predictable method of insuring that capital created from the sale of OPEC priced, non-renewable energy is reinvested in ways that can preserve and enhance our independence from increasingly uncertain world resource markets.

Revenues from a permanent national severance tax also could be used in the form of general revenue sharing, with two "pots" of money. One pot could be used exclusively to hold the energy producing states "harmless" in real dollar terms from the fiscal effects of replacing their severance taxes with a national severance tax. Thus, their tax base as of the year in which the change was made could be fully preserved. The second "pot" could be distributed under any fair formula; since the economic rent probably is extracted from consumers, consumption patterns might be used with other data elements in this formula.

This proposal is offerred not because we believe in it wholeheartedly but because it illustrates the need to find some solution that not only is fair to all parties concerned, but at the same time siezes an opportunity to address some of the difficult problems confronting our nation.

Failure to address the regional inequities created by the combination of federal energy policies and state energy severance taxation will, in the words of Felix Rohatyn, leave "half the country nearly bankrupt, many of its major cities pools of unemployment and unrest and the other half swimming in oil, industry, and wealth. This is not the stuff of a stable democracy; it is not the stuff of a union of states."7

NOTES

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1. Harley Duncan, "Tables on State Oil, Natural Gas and Coal Severance Taxation" (Washington, D.C.: National Governors Association, Center for Policy Research, March 6, 1980), Table V.

2. U.S. Treasury -- unpublished report.

3. "Why Alberta's Financial Power Scares Ottawa," Business Week, May 26, 1980.

4. The Decontrol of Natural Gas Prices -- A Price Americans Can't Afford (Washington, D.C.: Energy Action Educational Foundation, February 19, 1981), pp. V-VI.

5. The Federal Balance of Payments: Regional Implications of Government Spending (Washington, D.C.: Northeast-Midwest Institute, August 1980), p. 4.

6. Long Term Planning Needed in Oil and Gas Producing States, PAD 81-09 (Washington, D.C.: December 10, 1980), p. i.

7. Felix G. Rohatyn, Address before the Federal City Council, Washington, D.C., April 29, 1980, p. 7.

97th CONGRESS
1st Session

H. R. 1313

To amend the Powerplant and Industrial Fuel Use Act of 1978 to further the objectives of national energy policy of conserving oil and natural resources through removing excessive burdens on production of coal.

IN THE HOUSE OF REPRESENTATIVES

January 27, 1981

Mr. Gibbons introduced the following bill; which was referred to the Committee on Energy and Commerce

June 26, 1981

Additional sponsors: Mr. Winn, Mr. Kazen, Mr. D'Amours, Mr. Petri, Mr. Benjamin, Mr. Ertel, Mr. Conte, Mr. Jeffords, Mr. Frost, Mr. Donnelly, Mr. Frank, Mr. Traxler, Mr. Bonior of Michigan, Mr. Dwyer, Mr. Erdahl, Mr. Hughes, Mr. Ireland, Mr. Frenzel, Mr. Chappell, Mr. Kastenmeier, Mr. Luken, Mr. Oberstar, Mr. Lott, Mr. Ford of Michigan, Mr. Zeferetti, Mr. Wilson, Mr. Davis, Mr. Brodhead, Mr. Holland, Mr. Duncan, Mr. Pickle, Mr. Stenholm, Mr. Stangeland, Mr. Vento, Mr. Rangel, Mr. Wolpe, Mr. Vander Jagt, Mr. Bailey of Pennsylvania, Mr. Hance, Mr. Garcia, Mr. Blanchard, Mr. Clay, Mr. Fuqua, Mrs. Chisholm, Mr. Montgomery, Mr. Harkin, Mr. Hertel, Mr. Tauke, Mr. Florio, Mr. Rodino, Mr. Horton, Mr. Hagedorn, Mr. Lehman, Mr. St Germain, Mr. Crockett, Mr. Green, Mr. Aspin, Mr. Yates, Mrs. Fenwick, Mr. Derwinski, and Mr. Ottinger

---

A BILL

To amend the Powerplant and Industrial Fuel Use Act of 1978 to further the objectives of national energy policy of conserving oil and natural resources through removing excessive burdens on production of coal.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Congress finds that, in order to alleviate the national energy emergency, reduce national dependence on petroleum imports, encourage the highest and best use of domestic petroleum and natural gas, and enhance interstate commerce by promoting increased reliance on our national reserves of coal for the generation of electricity and power, it is necessary to remove excessive burdens on production of coal used in powerplants and major fuel-burning installations.

SEC. 2. (a) The Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) is amended by adding immediately following section 807 the following new section:

"SEC. 808. COAL FOR POWERPLANT AND INDUSTRIAL CONVERSION.

"(a) LIMITATION.—Notwithstanding any other provision of State or Federal law, with respect to any coal which is destined for shipment in interstate commerce for use in any powerplant or major fuel-burning installation, the sum of all severance taxes or fees, in respect of any fiscal year, levied upon or collected from any taxpayer, by a State or any political subdivision thereof on such coal or on any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of such coal shall not exceed a total of 12½ percent of the value of such coal produced during such fiscal year at the time it has been extracted and prepared for transportation free on board the production site, exclusive of all State and local taxes and fees.

"(b) SEVERANCE TAXES OR FEES DEFINED.—For purposes of subsection (a), 'severance taxes or fees' includes any tax or fee, by whatever name called, levied, or collected upon coal or upon any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of coal except for income, sales, property, or other similar taxes or fees of general application which are not disproportionately imposed thereon.".

(b) The table of sections for such Act is amended by inserting after the item relating to section 807 the following new item:

"Sec. 808. Coal for powerplant and industrial conversion.".

City of
MOORHEAD
Box 779
Moorhead, Minnesota [illegible]

July 28, 1981

Mr. Larry Hunt
Professional Staff Member
Sub-Committee on Inter-Governmental Relations
507 Carroll Arms Building
301 1st Street N.E.
Washington, D.C. 20510

Dear Mr. Hunt:

Enclosed please find a short paper outlining the existing major disparities between Minnesota and North Dakota. This data has not taken into account the 6.5% additional oil extraction tax which is expected to produce $290 million for the next biennium. The North Dakota estimate is based on 1979 production level and may significantly change within the foreseeable future. The total oil and gas revenues at the current level is anticipated to provide $250 million per year which is approximately 25% of the North Dakota State annual budget.

Please let me know if I can be of more assistance.

Sincerely,

Willis L Kingsbury

Willis L. Kingsbury
Director of Community Development

WLK:gs

Enclosure

Economic Analysis: Problems and Strategies
Moorhead, MN

For many years, disparities between the tax and regulatory climates in Minnesota and North Dakota have put Moorhead and other border communities at a disadvantage in competing with our neighbors across the Red River. In the past, Fargo's economic benefits have not been enough to seriously threaten the well-being of our city. The inflation and recession imposed hardships of recent years, however, have made these disparities an important consideration in the choices made by individuals and businesses.

There is evidence of this on many fronts. The 1980 Census figures show that Moorhead grew less than one percent during the last decade while Fargo grew 15% (Attachment A). Moorhead's public school enrollment has declined 32% since 1975, while Fargo's declined by 11% (Attachment B). An analysis of employment figures show a 14% increase in Fargo jobs but a 2% decrease in Moorhead jobs over the last five years (Attachment C). The value of commercial construction has been three times greater in Fargo than in Moorhead in the last ten years (Attachment D). At least a dozen businesses have left Moorhead to go to Fargo in the past five years. These disturbing trends have prompted a study of what the border-related factors are, so that we might develop strategies and legislative tools to address them.

Border City Disparities

Residents are most personally affected by the difference in personal income tax. For families who are not low income, Moorhead residency means a much higher state income tax bill than Fargo residency. For example, a simple comparison using standard deduction finds that a family of four with an adjusted gross income of $25,000 would pay $1,775 Minnesota state income taxes as compared to $446 North Dakota state income taxes, for 1980.

A survey of businesses that have left Moorhead to go to Fargo reveals that state income taxes, local property taxes, and workers compensation were the three most important reasons for doing so (Attachment E). Disregarding apportionment based on market, the Minnesota corporate income tax rate is a 12% flat rate on taxable income while in North Dakota it is graduated from 3% to 8½%. In Moorhead, property tax on commercial property with comparable market value is over twice that in Fargo, despite the lower per capita cost of government in Moorhead (Attachment F). Workers compensation costs to businesses are several times higher in Minnesota than in North Dakota, due both to substantially higher Minnesota rates and to salary limits on rates in North Dakota (Attachment G). An example of a disparity which is affecting one specific business is between the 8¢ per gallon gasoline tax in North Dakota and 11¢ per gallon tax in Minnesota.

The economic inequality is expected to worsen as energy development generates more revenue for North Dakota. It is clear that the time for action is now.

Economic Strategies

The City has been actively working with our legislators to counter those disparities created by state laws and policies. The City is also aggressively pursuing measures to make Moorhead a more attractive place for businesses and the people they employ. The following summarizes the status of these many activities.

District Heating

The development of this energy alternative has the potential to save the people of Moorhead $140 million dollars in energy costs over the next 20 years. This will be an important advantage to locating in Moorhead. The City has given high priority to passage of the district heating bonding bill, which will give Moorhead the opportunity to proceed with the project when appropriations are available. The bill has been passed out of House Energy Committee.

Property Tax Abatement

Sponsored by Representative Vaian and Senator Keith Langseth, this bill will allow Moorhead to provide the same opportunities to business in terms of abatement of real estate taxes that they have in Fargo. Senator Langseth has moved the proposed bill through the Senate Tax Committee and it should be heard on the senate floor April 2, 1981.

Commercial and Industrial Revenue Bonds

Moorhead has used commercial and industrial revenue bonds for several projects. We have adopted formal guidelines to assure responsible use of this economic development tool.

City officials are aggressively lobbying against a proposal to exclude commercial business from this type of financing. This is expected to be a difficult battle but one the City feels is important to win. The House Local and Urban Affairs Committee subcommittee on tax exempt bonds has passed an amended bill which would exclude border cities from the proposed restrictions on commercial use of industrial revenue bonds.

Tax Increment Financing

Moorhead has had success in financing development through this method in the past and has approved a $1.2 million tax increment finance plan for a 20 acre commercial development on Highway 10 East. The City is alert for potential legislative restrictions on tax increment financing and is prepared to work to protect it as an economic redevelopment tool.

Gasoline Tax

The City has worked with local gas station operators to document the effect the proposed gasoline tax increase from 11¢ to 15¢ per gallon would have on our community. This information has been presented to the legislature, along with resolutions opposing the increase from Clay County and the City of Moorhead, again bringing the lawmakers evidence of the special problems of the border. The City of Moorhead has requested legislation to decrease our gasoline tax to the same level as North Dakota's.

Tourism

There is great potential for development of tourism as a major economic activity in this area. The City is committed to the support of the Fargo-Moorhead Visitors and Convention Bureau as a means to realize this potential. The City is working for a bill authored by Representative Hoberg and Senator Langseth to permit a 2% hotel-motel room tax to generate revenue for the promotion of tourism.

Workers Compensation

A problem to border communities for years, the high cost of workers compensation has become critical statewide. It is a very difficult to address legislatively though members of both parties and Houses agree that it is out of control in Minnesota. The disparity is drastic and labor's desire to preserve the compensation system carries a great deal of influence. Nonetheless, workers compensation is expected to become a controversial political issue in this legislature.

Area Redevelopment Authority

The ARA city-county economic development body has increased the economic potential of the City in the creation of the new industrial park. This project teamed with district heating, the new wastewater treatment plant, and the availability of sites with rail provide an effective opportunity for the City to expand its industrial base. The ARA will act to build a solid industrial base for Moorhead in recruitment of business and review of industrial proposals for the park.

Border Cities Coalition

Having shared problems for years, the Minnesota Red River Valley cities are now working together on solutions. East Grand Forks, Breckenridge and Moorhead have joined to work with area legislators and together will be a strong voice at the State Capitol.

Fiscal Disparity Board

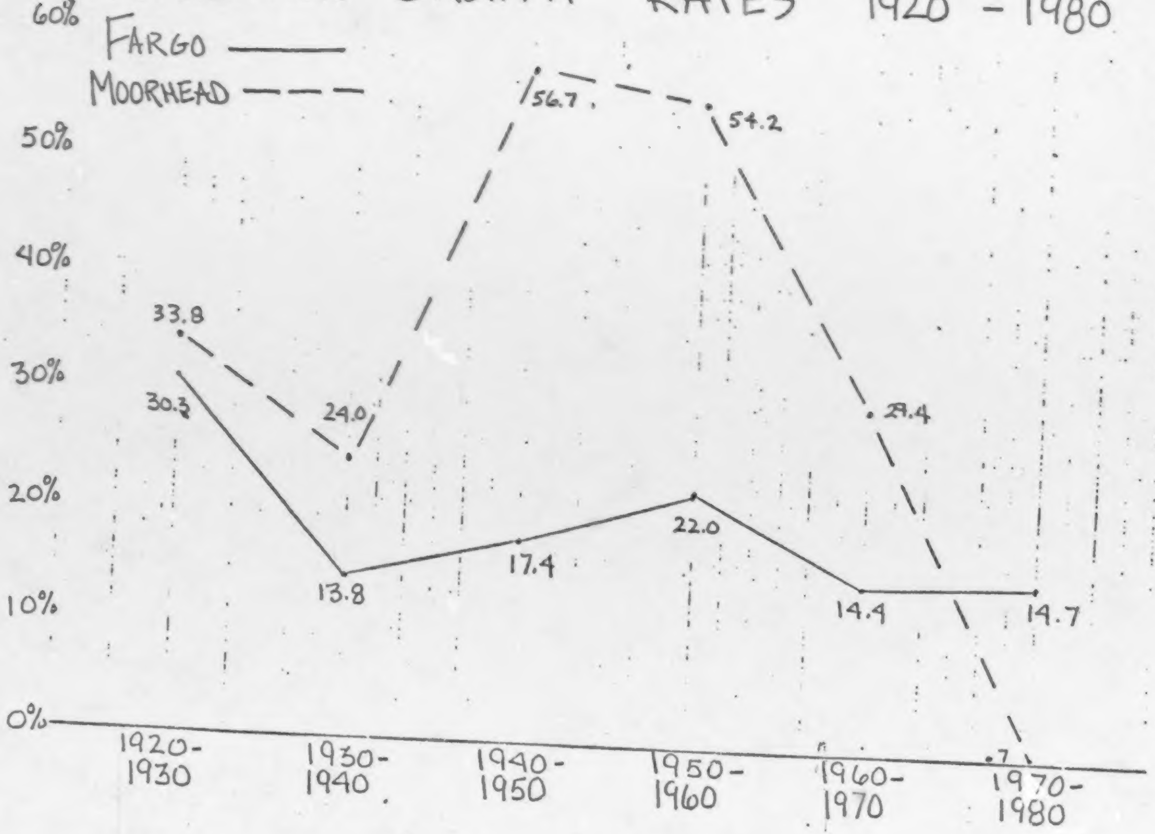
This concept would provide a more comprehensive approach to the solution of border-related disparities. It involves creation of a board to consider special exceptions or compensation for areas unequally disadvantaged by fiscal and regulatory actions of the state. The idea has not been formally proposed or worked out in detail, yet it could offer an excellent opportunity to correct many situations. The board could research the impact of the many inequalities and determine the proper adjustment for the affected area. A possible adjustment would be in the state aid formula. Representatives Valan and Hoberg plan to develop this concept into legislation for possible consideration this session.

The beginning of the 1980s find the City of Moorhead coping with the unpleasant consequences of long standing economic disparities. The difficult and divisive process of school closings is a prime example of how the disparities can seriously affect the community. The City must face our difficulties and do what is necessary to move forward in a positive manner.

Moorhead has many strengths and we are building on these strengths by actions at home and in St. Paul. The successful accomplishment of these economic strategies will put our community in the best position ever to economically compete with our neighbors.

Attachment A

POPULATION GROWTH RATES 1920 - 1980



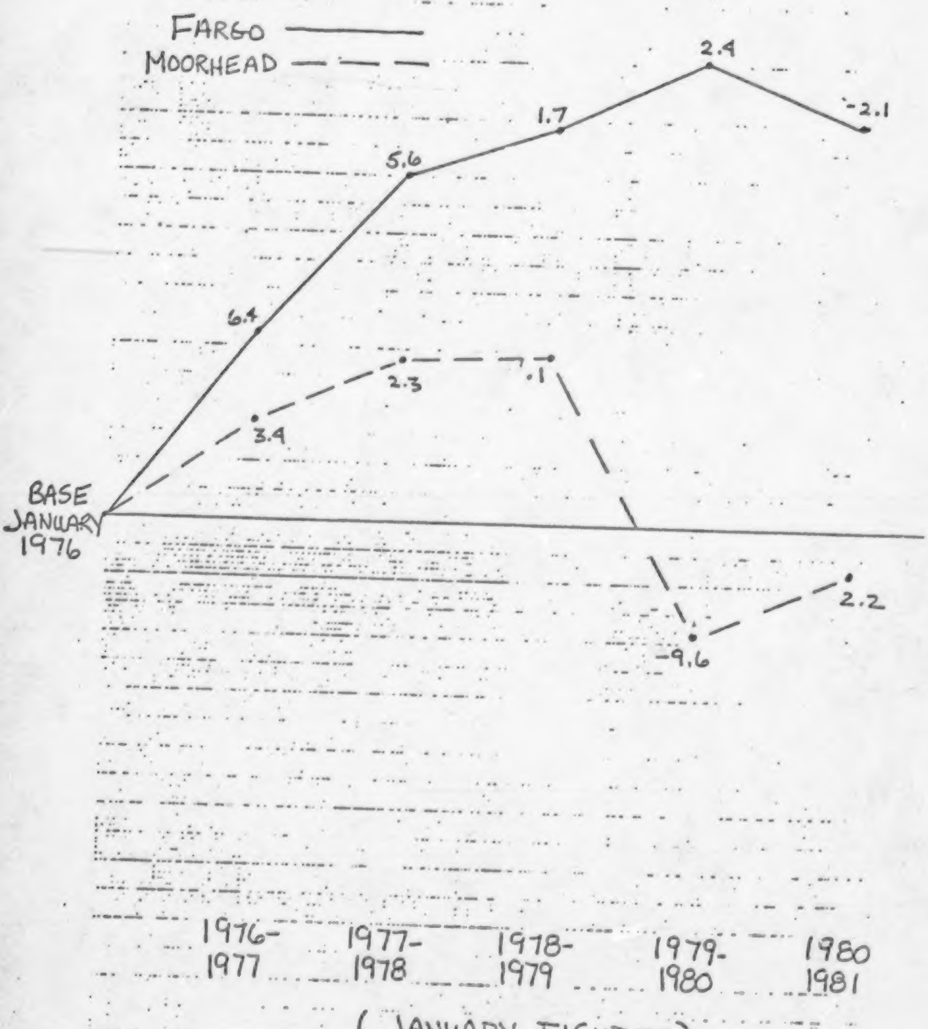
Attachment B

School Enrollment
1975 - 1980

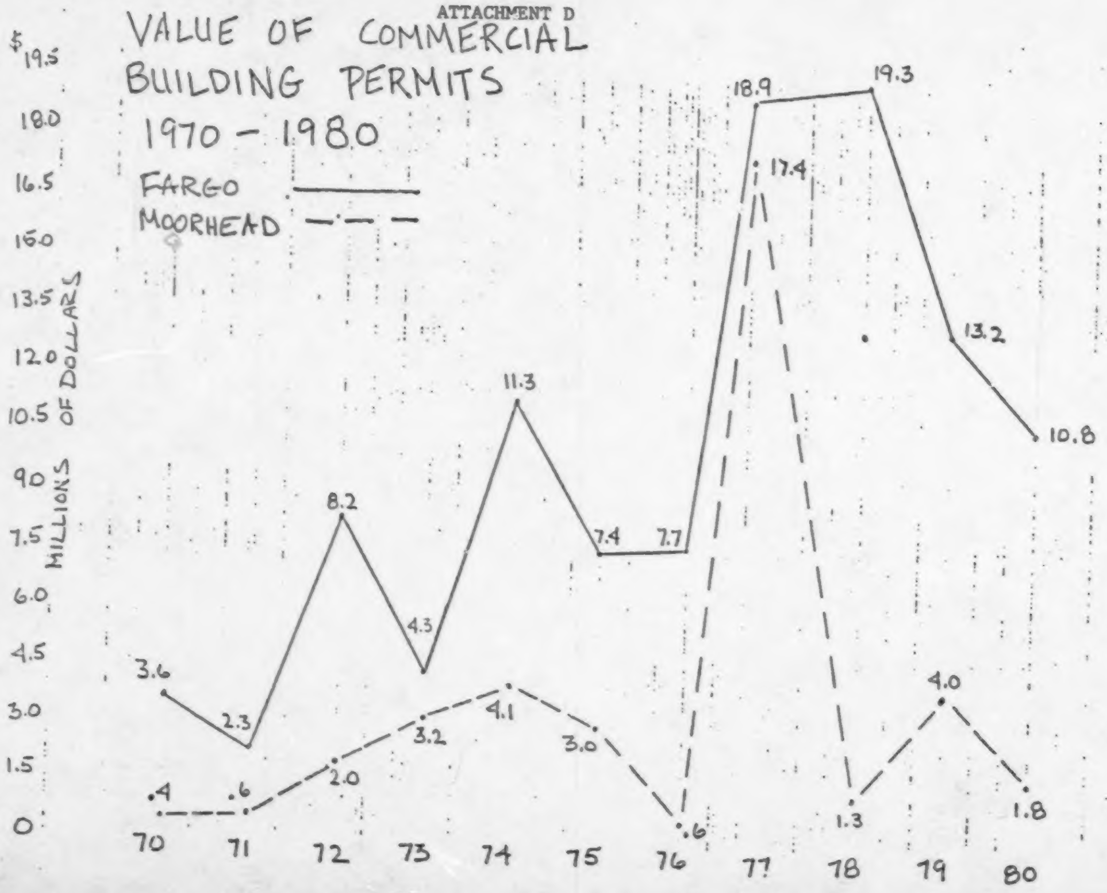
Year	Moorhead		Fargo	
1975	7,406		9,650	
1976	6,316		9,617	
1977	6,086		9,319	
1978	6,618		8,934	
1979	6,231		8,566	
1980	5,062		8,602	
Decrease	2,344	(31.6%)	1,048	(10.9%)

Attachment C

TOTAL EMPLOYMENT GROWTH RATES
1976-1981



ATTACHMENT D



VALUE OF COMMERCIAL BUILDING PERMITS 1970 - 1980

Attachment 2 - 1

Commerical Questionnaire Analysis

A total of 16 questionnaires were sent to commercial businesses that have in the last five years relocated from Moorhead, Minnesota to Fargo, North Dakota. One questionnaire provided information regarding a business that chose Fargo over Moorhead in their selection process. Eleven questionnaires out of seventeen were returned for a 65% return rate. The following survey results are provided.

1. Reasons for locating or relocating to Fargo. (Recipients were allowed to check as many as applied.)

No. of Responses	Percent of Respondents	
5	45	A. Minnesota Workmen's Compensation Payments
8	72	B. Minnesota Corporate and Personal State Income Taxes
5	45	C. Local property taxes
1	09	D. Special assessments
4	36	E. Existing customers are now located in Fargo
3	27	F. Desire to expand service area
-		G. Rental costs
3	27	H. Lease was terminated
-		I. Utility costs
4	36	J. Lack of space to expand
3	27	K. Inappropriate industrial/wholesale/retail locations
		L. Other
		- restrictive load limits on trucks
		- consolidation of offices to increase efficiency
36		

2. Which factor played the most critical role in your firm's decision to locate in Fargo?

No. of Responses	Percent of Respondents	
1	13	A. Minnesota Workmen's Compensation Payments
3	38	B. Minnesota Corporate and Personal State Income Taxes
-		C. Local property taxes
-		D. Special assessments
1	13	E. Existing customers are now located in Fargo
1	13	F. Desire to expand service area
-		G. Rental costs
		H. Lease was terminated
-		I. Utility costs
1	13	J. Lack of space to expand
1	13	K. Inappropriate industrial/wholesale/retail locations
8		

Attachment E-2

3. What attracted you most to Fargo?

No. of Responses	
6	Tax climate including personal, corporate and tax exemption alternatives.
2	Better commercial and industrial site locations.
8	

Conclusions:

A total of 72% of the respondents indicated that Minnesota's Corporate and Personal State Income Taxes were a reason for relocating to North Dakota. Another 45% felt that workmen's compensation and local property taxes affected their decision to move. The survey concludes that state regulated programs have had a significant impact on the reasons behind a firm's decision to leave the state and relocate just across the border in Fargo, North Dakota.

Attachment F-1

COMMERCIAL PROPERTY TAX

ESTIMATED MARKET VALUE	FARGO	MOORHEAD
$150,000	$ 2,675.74	$ 6,643.50
375,000	6,688.35	16,608.75
900,000	16,052.04	39,861.00

Attachment F-.

Comparison of Per Capita Real Estate Taxes
Generated in Fargo and Moorhead
1970 - 1980

	1970	1975	1980	1985
Fargo	$182	$229	$322	$240 (1)
Moorhead	$148	$192	$220	$250 (2)

(1) Based on reduction of taxes due to increases in state revenues from energy development.

(2) Based on average increases during 1970 - 1980.

Comparison of Per Capita Real Estate Taxes
Used for City Government Operation
In Fargo and Moorhead
1970 - 1980

	1970	1975	1980	1985
Fargo	$52	$59	$73	$50 (1)
Moorhead	$25	$37	$54	$60 (2)
% Higher than Moorhead	108%	59%	35%	

(1) Based on the latest assumption for a four year cumulative reduction of taxes because of the revenues from oil taxes.

(2) Assumed to increase 10%.

Attachment G-1

COMPARATIVE STUDY:
WORKER'S COMPENSATION INSURANCE
MINNESOTA vs. NORTH DAKOTA

This study is based on a comparison of 215 job classifications of a total of 332 Minnesota classifications. Those omitted were not readily comparable to North Dakota classifications.

Minnesota is in the process of reviewing new Worker's Compensation rates. This study uses both the existing and the proposed rates. The actual new rates set by the State Insurance Commissioner will likely differ from those proposed. The actual rates will be used for an updated study when they are adopted.

Rates are per $100 of payroll. In North Dakota, rates are applied to the first $3,600 of payroll. In Minnesota, Worker's Compensation rates are applied on total payroll. Disregarding differentials in rates between the two states, this results in worker's compensation payments three times higher in Minnesota than in North Dakota in the $10,000 salary range, four times higher in the $15,000 range, six times higher in the $20,000 range, etc.

On top of this, rates are generally considerably higher in Minnesota.

Of 215 compared, 141 (65.6%) job classifications had higher Worker's Compensation rates in Minnesota than in North Dakota. Under the proposed rates, 194 (90.2%) would be higher.

On the average, Worker's Compensation rates for jobs studied were 49.6% higher in Minnesota than in North Dakota. Under proposed rates, the same rates average 93.6% higher.

Of the 215 classifications, 23 were twice as high in Minnesota, 8 were three times higher, 7 were four times higher, and 2 were five times higher. With the new rates, the disparities are even greater.

Attachment G-2

COMPARATIVE ANALYSIS: WORKERS COMPENSATION
NORTH DAKOTA vs. MINNESOTA

Example Jobs

				MINNESOTA			
	Annual	NORTH DAKOTA		Existing		Proposed	
Job	Salary	Rate	Total	Rate	Total	Rate	Total
Boilermakers[1]	$25,584	$13.20	$475.20	$12.14	$3325.58	$14.08	$3602.23
Bricklayers[1]	26,104	4.50	162.00	5.56	1451.38	9.51	2482.50
Carpenters[1]	23,587.20	8.75	315.00	14.31	3375.33	19.78	4665.55
Electricians[1]	24,024	2.95	106.20	3.04	730.33	4.13	992.20
Painters[1]	18,616	6.55	235.80	7.90	1470.66	13.51	2515.02
Plumbers[1]	23,171.20	6.40	230.40	7.25	1679.91	10.51	2435.20
Truck Driver[1]	16,723.20	11.40	410.40	11.50	1923.17	15.55	2600.46
Firefighter[2]	16,000	11.60	417.60	9.87	1579.20	16.48	2636.80
Clerical Office[3]	11,232	.37	13.32	.23	25.83	.31	34.82
Retail[4]	8,320	1.80	64.80	1.20	214.66	1.99	165.57

[1] Based on Federal Wage determination as issued by Secretary of Labor

[2] Based on approximate Moorhead firefighter salary

[3] Based on $5.40/hour

[4] Based on minimum wage $3.25/hour

Attachment G-3

Example Classifications

	North Dakota	Proposed Minnesota	Minnesota Rates Adopted in 1978
Creameries	7.50	9.21	9.21
Bottling	4.30	7.58	4.95
Paper Goods Manufacturing	1.35	7.17	5.07
Fertilizer Manufacturing	5.05	11.03	7.55
Drugs Manufacturing	.93	5.28	3.73
Furniture Manufacturing	4.55	13.30	8.01
Foundaries - Iron	6.35	30.49	19.86
Plumbing Supply Mfg	2.70	12.41	7.60
Concrete Products Mfg	9.55	16.31	13.46
Painting, Decorating	6.55	13.51	7.90
Roofing	13.00	32.14	24.41
Boat Building	6.35	13.70	9.77
Grocery Stores	1.20	3.86	2.33
Clothing Stores	1.20	1.90	1.43
Florists Stores	1.20	3.58	2.37
Hardware Stores	1.75	4.24	2.53
Seed Merchants	4.90	11.46	6.96
Building Material Yards	3.45	8.74	6.04
Hotels	2.95	3.80	2.58
Restaurants	2.25	3.80	2.58
Bowling Alleys	2.25	5.16	3.39

97TH CONGRESS
1ST SESSION

S. 178

To amend the Powerplant and Industrial Fuel Use Act of 1978 to further the objectives of national energy policy of conserving oil and natural gas through removing excessive burdens on production of coal.

IN THE SENATE OF THE UNITED STATES

JANUARY 21 (legislative day, JANUARY 5), 1981

Mr. DURENBERGER (for himself, Mr. BUMPERS, Mr. BENTSEN, Mr. DANFORTH, Mr. JEPSEN, Mr. LEVIN, Mr. METZENBAUM, Mr. PROXMIRE, Mr. RIEGLE, and Mr. DODD) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Powerplant and Industrial Fuel Use Act of 1978 to further the objectives of national energy policy of conserving oil and natural gas through removing excessive burdens on production of coal.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the Congress finds that, in order to alleviate the national energy emergency, reduce natural dependence on petroleum imports, encourage the highest and best use of domestic petroleum and natural gas, and enhance interstate commerce by promoting increased reliance on our national reserves of coal for the generation of electricity and power, it is necessary to remove excessive burdens on production of coal used in powerplants and major fuel-burning installations.

(b) Title VIII of the Powerplant and Industrial Fuel Use Act of 1978 is amended by adding the following new section:

"SEC. 808. COAL FOR POWERPLANT AND INDUSTRIAL CONVERSION.

"(a) Notwithstanding any other provision of State or Federal law, with respect to any coal mined or produced from Indian lands or lands owned by the Federal Government which is destined for shipment in interstate commerce for use in any powerplant or major fuel-burning installation, the sum of all severance taxes, or fees, in respect of any fiscal year, imposed by a State or any political subdivision thereof on such coal or on any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of such coal shall not exceed a total of 12½ percent of the value of such coal produced during such fiscal year determined at the time it has been extracted and prepared for transportation free on board the production site but exclusive of all State and local taxes and fees.

"(b) For purposes of subsection (a), 'severance taxes or fees' include any tax or fee, by whatever name called, imposed upon coal or upon any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of coal except for income, sales, or other similar taxes or fees or general application which are not disproportionately imposed thereon.".

WESTERN COAL AND COMMUNITY IMPACT

Moorhead's Experience

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Willie L. Kingsbury

July 25, 1979

WESTERN COAL AND COMMUNITY IMPACT: MOORHEAD'S EXPERIENCE

Numerous state and national policies and programs in the areas of transportation, community facilities, housing, and resource allocation have been major sources of change regarding extent and direction of urban development. Although some of the policies and programs have individually been well intended, they lacked a comprehensive scope. As a result, they often conflicted and worked at cross purposes with other policies and programs. This has brought about confusion and chaos rather than harmony and order. In the field of natural resources, vast sums of money are devoted to flood control programs in the urban areas and yet a short distance away various programs for agricultural drainage aggravate the incidents of flooding in the cities. In the area of transportation, where the interstate system was intended to bring safety, access and convenience to the cities and region, it has resulted in numerous physical and social problems for the urban areas. The housing programs, though noble in concept, have contributed to a massive urban sprawl and still the housing needs remain largely unmet.

The most recent trends in national and to lesser extent state policies that will have long lasting effects on communities like Moorhead is in the area of energy development. The finite supply of oil in this country, its cost, and its availability from other countries is preparing state and national governments for substantial shifts in seeking other forms of energy. One of the most abundant sources of energy is western coal which even by conservative estimates offers a large reserve for meeting our energy needs for many years in the future. The crisis orientation nature of the governments' responces in programming for meeting the national energy needs is to look at cost and minor environmental side effects, while the greater impact on air, land and water resources, and the community is given secondary consideration. The emphasis on supplying the larger metropolitan areas with the energy derived from the western coal leaves the communities along the major rail routes in a difficult situation. Uncertainties about the increasing rail traffic which frequently bisects these cities not only makes the large scale city-wide redevelopment impractical but also keeps away the private sources of capital for investment. The suspense is costly and destructive to cities like Moorhead.

Setting

Moorhead, like many other cities in the Midwest, began its existence in the 1870's with the coming of the Great Northern and Northern Pacific Railroads. The original townsite was built around these two lines which were a few hundred feet apart. The railroad stimulated growth and a general harmony existed between rail activities and surrounding uses. The scale of rail activities, size of the trains, community design and movements of people and goods by railroad were less conflicting. Almost everyone knew that the "iron horse" was the only connection with the outside world for goods and services. Easier pace of life, and shorter distances to work, school or liesure produced no major conflicts. Growth of Moorhead and the coming of the automobile, however, began to show barriers to the free movement that the people were accustomed to. The two railroad tracks cross streets in the dowtown area in 11 places. A number of these streets like 4th, 5th, 8th and 11th Streets are major connecting links between the North and South sides. All of the banks, the City Hall, downtown mall, and a plaza are located between these two tracks. A major part of the urban redevelopment also lies here. The Clay County Court House, the hospital, the Law Enforcement Center and half of the City's major fire fighting capability is situated on the northside. The agriculturally related buildings for storage are located between, or to the north of the tracks. On the southside of the track, small retail establishments are located along Main Avenue. Beyond this area is a largely converted residential area which at one time had mostly single family homes. The Moorhead State University, Concordia College, the City Power Plant, and most of the churches are located south of the rail lines. Farther south yet, one observes the proliferation of shopping areas around the major arterials and intersections. Because of the location of the wastewater facilities, a sugar beet processing plant on the northside, and most importantly the location of the railroad tracks the growth is directed to the south in a linear fashion. Approximately 75% of the residents live south of the tracks.

Existing Conditions

All of the North-South thoroughfares leading to the central business district are intersected by the railroad tracks making accessibility difficult. Because of these particular characteristics, the rail lines attract certain uses more compatible with noise, vibration, and perhaps unaesthetic character. Storage, both indoor and outdoor (unless heavily controlled by the local zoning ordinances), warehousing, small light manufacturing, and agriculturally related uses are attracted to the areas adjoining the tracks. By virture of their unwanted characteristics, these uses, of necessity, are buffered by other uses to gradually make the areas acceptable for retail trade, offices and housing. In Moorhead, because of the geography and low train volume in the past, the buffer uses are either thinly placed or nonexistent. There are two major problems in this system of land use: (1) the area has less flexibility for future changes because of smaller acreage; and (2) the intensity of train movement will lead to rapid loss of locational value of structures and result in less compatible retail and service uses in the central business district.

In recent years, because of increasing train volume, there have been numerous proposals by the public and their elected officials emphasizing a need for correcting the problems of circulation and land use. Transformation of the Central Business District (CBD) from a center for retail business for the community to a selected shopping area and professional office center is a growing problem. The access and circulation, which are likely to dramatically worsen, have been one of the major causes for pushing small businesses into the suburban shopping areas. Even more seriously, because of competition and low business volume, they have eliminated some businesses.

The traffic volume is not anticipated to dramatically change in the foreseeable future. At the same time, train movement is expected to increase sharply.

Western Coal

The need for energy generation in larger metropolitan areas and shortages of other energy forms has made coal attractive. A large part of the western coal, bound for the eastern industrial cities or other communities along the Burlington Northern line, goes through Moorhead. Projections for anticipated number of unit trains traveling through Moorhead is difficult. Even Burlington Northern Railroad is unable at this point to give an indication of what it might be beyond 3 to 5 years. The changes in emphasis on national policy for coal extraction and consumption could drastically alter this picutre in a short period of time.

Under different scenarios, it has been estimated that coal consumption by the year 2020 could quadruple the projected levels for 1985. (Western Coal Planning Assistance Project, Missouri River Basin Commission, January, 1979). The following table shows projected coal production for North Dakota, Montana and Wyoming under different sets of assumption.

ANNUAL COAL PRODUCTION (MILLION TONS/YEAR) SUBSTATE AREAS (HARZA STUDY)

Scenairo and Disposition	North Dakota		Montana		Wyoming		Totals
	Substate Areas						
	1	2	3	4	5	6	
1985 and 2000 Low	11	.5	0	25	74	0.5	111
1985 Most-Probable	17.2	19.5	0	84.6	38.0	3.5	162.8
2000 Most-Probable	112.4	30.9	38	200	128.5	3.5	513.3
1985 High	53.8	7.1	29.2	100.0	100.0	3.5	283.9
2000 High	158.2	30.1	200	200	200	3.5	791.8

Source: Western Coal Planning Assistance Project, Missouri River Basin Commission, January, 1979.

For example, the accelerated scenario projects that North Dakota coal production will be 160 million tons per year by the year 2020 compared with current production of 8.5 million tons. It is expected that subbituminus coal in Montana, which is of higher quality, will be produced at a level under the accelerated scenario. North Dakota lignite, because of its higher sulphur content and low life expectancy, very likely will be used largely for electrical power generation near the mines and perhaps for some export to midwestern metropolitan areas. Montana production will be extensively exported to eastern markets. We have already seen large scale high voltage transmission lines criss-crossing the agricultural lands in our area, but we have not yet begun to carefully study their impacts.

Some sources project that Montana coal production may increase from 27 million tons in 1975 to 260 million tons by the year 2000 (Western Coal Mining Assistance Project). While it is not certain what the level of coal production within the next 10 years will be, one thing is certain and that is there will be increased coal train traffic passing through Moorhead and other communities along the rail lines.

Train Volume

There are currently approximately 20 switching actions and 32 through trains severing Moorhead daily. The number of through trains is projected to rise to 45 by the year 2000 (Metropolitan Auto Rail Study, Bather, Ringrose and Wolfsfeld, December, 1975). If one compares projections for coal production, it becomes apparent that the projection of train movements are low considering that the tracks going through Moorhead are one of two principal coal shipment routes. Even at this low level, the CBD area will need to channel 60 trains a day. If the trains move at an average of 25 miles per hour, 8 crossings will be closed at one time for about 5 minutes. For 60 trains, these crossings could be potentially blocked for 2 - 5 hours a day. The consequences are devastating for the central business district. Over a period of time the problems of access will become so acute that existing retail and service commercial uses will be gradually forced out to suburban regional shopping facilities. Redevelopment for the downtown area will become extremely difficult due to decreasing accessibility.

In fact, there may be very little impetus for further redevelopment and many new buildings will be led to premature obsolescence.

Negative environmental effects of the increasing coal train volume are many and cause noticeable disruption in the quality and range of services in the short-run, and drastic changes in the functions of the CBD in the long-run.

Short Term Impacts

In the short-run, increasing coal trains cause disruption in the movement of automobiles into the CBD, delays in emergency services, delays to work, delays to shopping and recreation, and general detrimental effects on sales and services.

Accessibility:

The blocking of intersections for extended periods of time during the day, particularly in the peak traffic hours, disrupts the movement of vehicular traffic in the Moorhead downtown area. For example, the new mass transit system of Moorhead, crosses the railroad tracks in the CBD area 112 times a day. If half of the busses face stoppage by 50% of the trains, the mass transit can literally not function and becomes ineffective.

Emergency Vehicle Delays:

Moorhead's Law Enforcement Center, St. Ansgar Hospital, one fire hall, and Clay County Court House are located on the northside. When the grade crossings are blocked, immediate responses to emergencies are very difficult intensifying already critical situations. There are numerous complaints by the police, fire, and hospital staffs at present pointing to the gravity of the situation in the future. Making each area of the City independent of other areas has major implications regarding tax needs.

Delay to Work:

The CBD is a major center for employment of a broad category of people. Inaccessibility and delays affecting this area may result in gradual relocation of businesses to other parts of Moorhead with better accessibility or even to North Dakota, which has already captured many of the businesses and services in the Metropolitan area. Such impact translates into financial losses to both the private and public employment sectors.

Delay in Shopping and Recreation:

The net effect of poor access, slow movement of automobiles, and frustration of the public will have substantial impact on the appeal of shopping services in the CBD already in heavy competition with suburban shopping centers. The gradual loss in volume of retail business will eliminate some services selectively which may develop in a chain reaction for bankrupting others.

Other Environmental Impacts:

Noise, vibration, and poor aesthetics are among other negative factors that discourage further use and investment in the CBD for shopping and services. They are a major constraint in attracting retail services and financial institutions.

Long Term Impacts

If coal train volumes continue to increase during the next 10 - 15 years, there will be some major shifts in the functions of retail businesses and services, loss of environmental desirability because of obsolescence of buildings, and finally major setbacks for economic development.

Obsolescence of CBD:

The changing pattern of shopping resulting from less frequent trips downtown and movement of professional and service facilities will result largely in changing the need and reasons for retail shopping and services in the CBD. In the chain of events, once the primary services are affected, the secondary businesses reliant on the primary businesses will be also affected. The resultant is lower volume of business, reduction in employment in the early stages and major losses at the subsequent stages. The overall effects of this change is a large number of vacancies in all buildings including the residential buildings, which are heavily dependent on the CBD. Declining central neighborhoods, in turn, affect adjoining areas and make them less desirable for residential occupancy. Elderly housing facilities located on the northside of the tracks also will be affected since the convenience of shopping is removed from the dowtown area. The forces of suburban shopping centers in the Metropolitan area, particularly on the Fargo side, will be too great and the businesses will take the path of least resistance. What Moorhead CBD has acquired over the last 20 years of redevelopment effort will be lost in fewer years in the future.

Environmental Desirability:

Changing functions of the buildings, impact on the central neighborhood, increasing noise and vibration lead the CBD to accommodate those uses most compatible with the rail movement. It is expected that, because of the particular characteristics of the railroads, more warehousing and light manufacturing uses will occupy spaces in the central parts and other more compatible uses in the outlying areas. The change is inevitable and the basic question remains how much change and how fast and to what extent we can adapt the existing buildings to the rail oriented uses. The area may very likely lose all of its attraction as a retail and service center, and become a light industrial district.

Implications of these consequences are grave. Loss of taxes both from retail and service structures, deteriorating residential uses in the fringe area, loss of employment sources, some of which may totally leave the state spell economic hardships for Moorhead.

Alternatives

In Moorhead, the coal train despite its problems offers new opportunities for the public and private sectors. It perhaps is the biggest challenge in the history of the City. The question here is how to avoid the negative aspects by changing those into opportunities for betterment of the community as a whole and perhaps also the Fargo-Moorhead Standard Metropolitan Statistical Area.

Extensive studies since 1975, show that Moorhead must maintain and improve a balance among residential, commercial and industrial sectors to compete with its neighbor city, Fargo, which, because of differences in state laws, is more conducive to new development. It has been demonstrated that sound planning, persistence and patience can make Moorhead attractive to investment despite its limitations in the tax climate. The City and the public have known that Moorhead, like other communities, will change over time. The question is the quality of the change and its cost both direct and indirect--some measurable in dollar terms and others stemming from people's values and preferences immeasurable in a material sense.

The auto rail conflict has given an impetus for a new look at the community resources and to address existing issues and adopting sound policies in order to avoid large problems in the future. In 1975, a study prepared by Bather, Ringrose and Wolsfeld delineated some alternatives for avoiding further conflict with the trains in the CBD area. A number of these solutions deal with grade separation, railroad track consolidation and railroad track bypass. Within each of these alternatives there are several options in terms of the route and number of grade separations.

Alternative #1 Grade Separation:

This series consists of sub-alternatives ranging from 1 to 3 grade separations in the downtown area. Because of the insufficient distance between the tracks, it may become necessary to either span both sets of railroad tracks at one time, or offset one north-south street to be connected to another north-south street. In either case, there are major adverse effects on adjoining land uses, impairment of direct access to the lands near the overpasses in addition to the environmental effects of vibration and aesthetics. The problem of dividing the downtown and forming a barrier on the eastside of CBD is a major constraint. While the movement of automobiles on a north-south direction will be improved, the question of access because of the canyon of concrete and steel remains the same. The long term effect is perhaps less use of CBD for retail and services. These alternatives are easier to implement but because of the long term impact and significant effects difficult to justify. They also lack the support of the business community.

Alternative #2 Track Consolidation:

This alternative looks at consolidation of the two tracks with empashis on Northern track for through movement. The consolidation requires that Fargo and Moorhead develop joint policies for limiting the local train movement to the southern tracks. Together with a number of overpasses in key locations on the northern track and intersecting streets, the track consolidation will aleviate part of the problem.

While this alternative presents less disruption in the commercial core, the total train movement still will have some adverse effects on the adjoining land. The general movement from the CBD to other parts of the community will greatly be enhanced, yet the land uses on the northside remain under pressure because of access to some parcels near the grade separations. The noise, vibration and asethetic aspects, because of increasing train movement, will have an effect in the CBD and may discourage further retail and services expansion.

Alternative #3 Bypass:

Two routes for bypassing the Metropolitan core were examined--one on the northside and one on the southside. The existing lines will be only used for passenger service and serving the metro area. The growth of the metropolitan area in the future and emphasis on the use of fixed lines still promises increases in the train volume. Together with a bypass system, additional grade separations away from the CBD and at key locations are still necessary. This particularly applies to the fringes of the city or the developing areas.

This alternative is costly and requires extensive land acquisition and bridge construction on the Red River of the North and the interstate highways. It will significantly remove the environmental problems related to noise, vibration, aesthetic and the existing grade crossings, and in absence of through trains, would pose much less problems for the CBD to continue as a center for retail and service uses.

The Future

The foregoing discussion on auto-rail problems once again opens up a new horizon for Moorhead for developing the sophistication and skill to turn problems into opportunities. All of the alternatives we have discussed have some adverse effects--some more on the physical environment than others. The key to considering the best alternative is not the present cost-benefit ratio or political or social impact, but is in the selecting of the alternative that preserves the interest of the City most effectively. If the preservation and enhancement of the CBD is the over-riding consideration, then perhaps the most likely alternative should be a metropolitan bypass. The Moorhead City Council has selected bypass as its only reasonable alternative with one strategically located grade separation to allow for internal emergency vehicle movement. It is by far the most expensive and most difficult to implement. In the long run, however, it is the most effective way of managing the rail transportation and other community resources in the area.

If we begin to comprehend how the producers and consumers of the coal-energy development will be benefiting at the expense of cities like Moorhead, we should be able to devise a mechanism to avoid the burdens. The coal that is mined in Montana and converted to energy in Detroit, Chicago or Kansas City impacts directly many communities in between. Even though the multiplier effects and economic dependency brings a part of the benefits to these communities by and large the overall impact is negative and difficult to comprehend.

If the emphasis in national policy is on coal, then not only the railroad, but also the cities which are likely to be affected must be assisted. Typically the federal/state government response is slow and many times so late that many opportunities are lost. When a decision is made to reach a goal, only that goal is kept in mind and other implications are neglected or forgotten. What this points to is absence of comprehensive policies at the state/federal level for meeting a broad range of needs in an interrelated fashion.

We have been planning for a long, long time in this country but only in a fragmented way and in small increments. Disjointed incrementalism is one of the main characteristics of decision making, particularly at the higher levels of government. It has led to emergence of new techniques in the public policy arena to assure that something is always left for tomorrow to protect somebody's turf. Unfortunately the personal turf and public interest have little in common. The preserved turf in fact might well work at the cross purpose with the public interest. The dilemma is real. Unless the state and national policies for resource and energy management truly reflect the needs, the preferences, and desires of the localities, there is every reason to believe that disjointed incrementalism will continue to work against us.

It is an opportune time to develop a comprehensive, well integrated, and long range policy plan to meet the energy needs of the country without significant effects on rural or urban environments. A strong partnership among federal, state, local, and private sectors (including the energy producers and railroads) would assure successful management and implementation of these plans.

[From the St. Paul Dispatch, June 21, 1978]

LONG RUNNING COAL TRAINS ISOLATING CITY'S DOWNTOWN

(By Gordon Hanson)

MOORHEAD.—Long, slow-moving western coal trains—their numbers swelling because of the energy crunch—apparently are creating greater financial and safety problems for scores of Midwest towns.

"The problem is so big nobody wants to tackle it," contends Willis Kingsbury, Moorhead's director of community development.

He says the economic lifeblood of this western Minnesota city of 30,000 is threatened by the trains.

In the last decade, this western Minnesota city has gone through a $21 million downtown urban renewal program. City officials say there are 53 train movements through the business district daily, which thwart traffic.

"The man who has to fight a train to get to his job or bank or doctor will wait for it to move past, but the average retail shopper won't take the casual risk of running into a train," Kingsbury said.

"They'll go somewhere else to shop. People are not trying to penetrate those tracks."

Two Burlington Northern tracks divide Moorhead's business district.

"The trains have a tremendous impact on the whole tender episode of the survival of downtown businesses," Kingsbury said.

Moorhead isn't alone, critics contend.

They claim that dozens of cities along the Burlington Northern line in Minnesota and North Dakota are subjected to lumbering trains—up to 100 cars long—that threaten to block emergency vehicles, prevent motorists from easy access to downtown shopping, create safety hazards and cause environmental and community development problems.

And because some industries are switching to coal to lessen the demands on oil and electricity for fuel, state officials expect the number of coal trains to grow significantly in the next two decades.

Kingsbury says the affected communities are the only ones not getting financial help to ease the situation.

"There are basic state and federal programs to assist communities" where the coal is produced, Kingsbury said, "At the other end, where they use this energy, they are helping industries convert from oil and electricity for the use of coal."

"We're in the middle between the resource and delivery end, and there is nothing available to really assist Moorhead with the impact of the trains on its environment."

Consequently, nearly two dozen towns in Minnesota and North Dakota have formed the Rail Traffic Task Force.

To find solutions, they have banded with the Minnesota Transportation Department, the North Dakota Highway Department and the Burlington Northern.

They have asked the federal government for $150,000 to try to find low cost ways of coping with the trains along the Burlington route, extending from Beach in western North Dakota, through Bismarck, Jamestown and Fargo-Moorhead, and east to Minneapolis via St. Cloud and Duluth.

"We know the problem is out there, we're just trying to find where it's at," says Gary Berreth of the North Dakota Highway Department.

"Federal agencies are in favor of the study, but are having trouble finding grant money for us to do it with."

Two main lines run parallel, 300 feet apart, through downtown Moorhead.

"They've got to run the trains," concedes Ken Hart, co-owner of an auto parts store in Moorhead, "but they louse up traffic so bad. I've seen traffic backed up for two blocks. I'm sure some people go away when they might have stopped here."

His store is about 50 feet from one set of tracks. "Every day I see people drive between the (traffic gate) arms to beat a train. Some day, somebody isn't going to make it."

"A couple of underpasses would make one heck of a difference," adds Hart's partner, Jim Binger. "My wife works at St. Ansgar's Hospital. She leaves for work a half-hour early to allow for the trains."

[From the Minneapolis Tribune, May 31, 1981]

THE STATES' FINANCIAL CRUNCH

(By Neal R. Peirce)

LOS ANGELES.—State governments, already beset by severe financial crunches caused by tax lids and recession, are likely to be the fulcrum of a roaring fiscal crisis when the Reagan administration's full budget cuts take effect next autumn.

But if you would like a preview of how difficult the future may be, you will have to wait no longer than July 1. That's the date California and Massachusetts start new budget years. Both will be going "cold turkey" with budgets reflecting the extreme of what the voters have wrought in their celebrated modern-day tax revolt.

California faces its day of reckoning because the immense $5-billion state surplus, which it's been using to bail out localities ever since Proposition 13 was voted in June 1978, has now been whittled down to the vanishing point. For the first time in three years, Gov. Jerry Brown was obliged to recommend a truly balanced budget.

The Massachusetts outlook is, if anything, grimmer. Disgusted by local property taxes that climbed to a level 81 percent over the national per-capita average, Bay State voters last fall voted overwhelmingly for "Proposition 2½". Under the initiative, property taxes must decline in stages until they equal no more than 2½ percent of fair market value. And Massachusetts has no holdover surplus with which to cushion the blow.

The issue in the two states is the same: Will state government, either by raising taxes or cutting into its own operations, come riding to the rescue of local governments? And the answer in both is probably not. Legislators are unlikely to court voter wrath by raising taxes in a ferocious anti-tax climate. And it's easier to let localities twist slowly in the cold fiscal winds than to cut state-level payrolls.

Though the California Legislature may lighten the blow, Brown's budget would cost California city and county governments $700 million in the aid levels set for them by state law just a year ago.

That could cost Los Angeles $80 million. But the city, wracked by spiraling police- and fire-pension costs, is already on the fiscal ropes. Even before state cuts—not to mention the federal cuts to come later—it faces the necessity of reducing its work force by 1,200, putting branch libraries and recreation centers on half-time operation and allowing street resurfacing to slip to a once-every-130-years' schedule.

Additional user fees are scarcely the answer, says chief administrative officer Keith Comrie. "We already have every fee you can think of. We charge for building and safety and planning permits, for swimming pools, golf courses, the zoo, you name it. But how do we come up with a fee for police?"

Los Angeles County Executive Harry Hufford, whose budget faces heavy cuts in health, welfare and criminal-justice programs, notes: "People want less government, but always say cut the budget elsewhere. But city and county parks are jammed on weekends. Hospital clinics are full. Welfare loads are going up. Inner-city schools are crowded. People call for law and order, but the jails are already overcrowded. The buses are a disgrace. These are the issues. We'll provide the government people are willing to pay for."

In Massachusetts, surveys indicate that as many as 20,000 city and town workers will be laid off, including 1,300 policemen, 1,400 firemen and 9,000 teachers. Boston has already had its Moody's bond rating suspended and has fired hundreds of employees. Mayor Kevin White is coming under vitriolic attack for his alleged battalions of patronage workers. The politically contentious Boston School Committee overspent its budget by tens of millions, threatening early shutdown this spring. Impartial observers don't rule out the city being forced into receivership by June 30.

But cities far better run than Boston are suffering, too. Proposition 2½, says Cambridge City Manager James Sullivan, "requires cities and towns to dismantle their governmental structures."

Perhaps that's what citizens want, but one wonders. They know, for instance, that Massachusetts cities are rife with abuses, such as padded payrolls and unlimited sick leave for policemen. Californians hear true stories of fire and police pensions costing Los Angeles and Oakland 75 cents for every dollar of salary paid an active employee. Change must come, says Los Angeles Councilman Marvin Braude: "You simply cannot bankrupt the city in order to pay pension benefits for firemen and police."

It is a fact that the tax revolt would probably never have erupted in Massachusetts if state legislators had had the stamina to break binding arbitration for unions and the fiscal autonomy of free-spending school boards, to place caps on local spending and enact a graduated income tax.

And, in California, "Little Hoover Commission" chairman Nathan Shapell charges that literally billions of dollars a year are being wasted by profligate school boards, which allow costs to escalate as enrollments plummet, and in the "Medi-Cal" program, which has mushroomed in expense seven times over in seven years. Both systems, he says, are plagued by gross mismanagement and lack of cost controls.

If there is a silver lining in the tax revolts, it may be to focus attention on the ultimate wielders of state-power control: state legislators. The glare of publicity may force them to effect belated change. Certainly they can no longer pass the blame off on localities. For the tax initiatives have stripped cities, towns and counties of the right to raise taxes, and thus govern independently. Home rule—at least for the foreseeable future—is dead.

That means that states will have to take the needs of cities and counties a lot more seriously—shifting, as Los Angeles' Hufford puts it, from a "us-them" to an "us" relationship. Perhaps that's too much to expect of embattled politicians. But it may be Step One in climbing out of the acrimonious pits of the tax revolt.

[From the Minneapolis Tribune, May 31, 1981]

MINNESOTA HAS THOSE OLD "BORDERLINE BLUES"

(By Steve Berg)

MOORHEAD, MINNESOTA.—Appropriately, the mayor's desk faces west.

And from his window high up in City Hall, Morris Lanning can look down at the Red River, a muddy little stream that forms the border between Minnesota and North Dakota, and he can look out at the buildings of downtown Fargo just a few blocks away.

The city across the river is bustling with new businesses, new jobs, new houses, new people.

Lanning's town looks green and prosperous. But that's a facade, he says. Moorhead and the other border towns of East Grand Forks and Breckenridge are being bled white by high taxes and by people with good, old-fashioned Minnesota common sense who have come to realize that they can live and do business much more cheaply by crossing a bridge to North Dakota.

North Dakota's income taxes are about two-thirds less; its sales tax one-fourth less; its workers' compensation insurance rates 50 percent less. Even with the freeze imposed on border gasoline taxes last week by the Minnesota Legislature, the North Dakota gasoline tax is one-fourth less. And its local property taxes, aided this year by $104 million paid to the state by coal and oil companies, are going down, not up.

To those who watch business, the consequences seem graphic.

Moorhead grew hardly at all over the last decade, while the population of Fargo and West Fargo shot up by 22 percent. More than a dozen companies have jumped the border in the last five years and nearly all new firms are picking the North Dakota side of the river. Moorhead's troubled public school system is losing pupils at triple Fargo's rate and has had to close nearly half its schools in the last five years.

1980 POPULATIONS

	Number	Change from 1970
North Dakota:		
Fargo	61,218	Up 15 percent.
West Fargo	10,080	Up 95 percent.
Grand Forks	43,760	Up 12 percent.
Wahpeton	9,065	Up 28 percent.
Minnesota:		
Moorhead	29,905	Up less than 1 percent.
East Grand Forks	8,537	Up 12 percent.
Breckenridge	3,990	Down 5 percent.

"We've had people suggest that I organize a pick and shovel brigade and dig a big trench on the east side of town to re-route the river," Lanning said, reflecting the sentiments of many here that if you can't beat North Dakota, you might as well join it.

"We could fill in the old river bed and turn it into the longest golf hole in the country," he said, laughing the same way he does when suggesting that Minnesota can solve its budget crisis by selling Moorhead to North Dakota for $600 million.

"With all the Norwegians in Moorhead (Lanning is one) we would raise the collective I.Q. of North Dakota by about 10 points," he quipped.

Disparities are nothing new between Fargo and Moorhead.

At the turn of the century, Fargo was dry and Moorhead had 52 saloons. Eventually Moorhead "reformed" and grew into a pleasant, cozy college town in which one-third of its residents were students at Moorhead State University or Concordia College.

Moorhead people have always been fiercely loyal to their city, believing it a bit more prestigious to live in Minnesota, a state of lakes and trees, rather than in North Dakota, a state with a sagebrush image and a reputation for fewer services and poorer schools.

"People have been willing to pay more for the so-called Minnesota quality of life," said Willis Kingsbury, Moorhead's community development director.

"Maybe some of that was valid in the past," he said, "but Fargo-Moorhead is really one community and I challenge anybody to show me how the schools or the quality of life is any better on one side of the river than on the other. Now it's the people of Moorhead who are caught in the wrong part of town."

Although tax disparities have existed for years, they suddenly seem more important for two reasons, he said. Inflation makes them more significant to people. And North Dakota is using its energy resources to widen the tax gap.

"We're living next to a new generation OPEC state," Kingsbury said.

This year North Dakota will collect an estimated $104 million from energy companies for the privilege of taking coal, oil and natural gas from its land.

As a result, collections from corporate income taxes are expected to drop by 15 percent and personal income taxes by 31 percent. The state is so rich it refused to raise gasoline taxes and other fees to maintain its highways and chose instead to use money from its general fund.

A new tax on crude oil will pump more money into education—$14 million more next year. The state's revenue from energy taxes could triple by 1983 when it expects to collect $304.6 million, fueling fears here that North Dakota could eliminate its income tax altogether.

That kind of wealth coupled with a populace that traditionally has not demanded the services Minnesotans have makes it easy for North Dakota to provide lucrative tax incentives for business.

A recent study by Alexander Grant & Co., a Chicago accounting firm, rated North Dakota the fourth best state in which to do business (after Mississippi and the Carolinas). It ranked Minnesota 37th. As Moorhead businessmen are fond of pointing out, the muddy little Red River is only 50 yards wide between their town and Fargo.

The cases of Moorhead, East Grand Forks and Breckenridge are not nearly so dramatic as the exodus from "Taxachusetts" to neighboring New Hampshire or the rebellion over California taxes. There's no real rebellion here. People are just slipping quietly across the river and smiling more at tax time.

Craig Johnson is one.

Johnson grew up in Sidney, Mont., moved to Moorhead 10 years ago to attend Concordia College and married a Minnesota woman from White Bear Lake. They lived in a Moorhead apartment. When it came time to buy a house last year, the Johnsons could have bought a comparable house for about $15,000 less in Moorhead. But they chose to cross the river and move into a two-story brick house in north Fargo.

"It came down to taxes," said Johnson, 28, tax manager for a Fargo accounting firm. "Had everything been equal, we would have preferred to stay in Minnesota. My wife, especially, feels an attachment. She almost cried when we had to put on the North Dakota license plates. But I see us both moving up in our careers and making more money. Taxwise, it just doesn't make sense to live in Minnesota."

Johnson backed up his opinions by hauling out two sets of tax forms. In Minnesota, a family of four with the husband earning $30,000 a year and the wife earning $15,000 would pay $2,700 in income taxes, he figured. In North Dakota, the same family would pay $820.

If the family lived in a home valued at $100,000, it would pay a property tax of $1,924 a year in Moorhead (that includes a $650 homestead exemption) and $1,450 in Fargo, according to figures supplied by city tax offices. The total tax savings in North Dakota: $2,354.

Many of those jumping the border or selecting the North Dakota side when first moving into the community are like the Johnsons, young and prosperous.

Victor Schramm has been a Moorhead home builder for 47 years. Now he specializes in building custom homes in the $100,000 to $250,000 range.

"Fifteen years ago, I never built in Fargo," he said. "Now, 90 percent of my business is over there." Schramm said he has built only one home in Moorhead in the last five years. He said, "It's lucky for Moorhead that interest rates are so high, otherwise more people would be moving."

Border patterns also are reflected in the schools where enrollment in Moorhead has dropped three times faster than in Fargo. In the last five years, Moorhead has closed six of 13 schools and laid off more than 100 teachers. Last week, the school board had to borrow $1 million to finish the term. No schools have closed in Fargo and West Fargo is planning a new school.

Some fear that more liberal welfare laws in Minnesota will further complicate the border towns' problems. "We don't want to become a welfare dump," said Mike Casper, city clerk in Breckenridge, a city losing out to Wahpeton, N.D., just across the river.

The business exodus has been more dramatic.

Leon Simon's father first opened a furniture store in Moorhead 55 years ago. Now Simon's only Moorhead outlet is a small odds and ends store open only part of the year. His two big stores are in Fargo.

"It became apparent that more of my affluent customers were not going to be living in Moorhead," he said. "It makes sense to be where your customers are."

A large furniture manufacturer dictated that one of his new stores be located near West Acres, Fargo's large regional shopping center. His other Fargo store was simply a good business deal.

Simon dislikes the notion that he has deserted Moorhead. He still owns a bank and two neighborhood shopping centers here. Still, he has moved his official residency to Florida. "My accountant told me I couldn't afford to live here anymore," he said, "that I'd be crazy to live in Minnesota."

Again, people here prefer to talk about the numbers.

A survey of 11 companies that had jumped the border from Moorhead to Fargo during the last five years showed that most relocated because of high income and property taxes and high workers' compensation payments.

A fast food restaurant valued at $375,000 would pay a property tax of $16,600 in Moorhead, for example, but only $6,688 in Fargo, according to the survey. In Moorhead, the owner of a trucking firm would pay $1,923 in workers' compensation premiums for every driver making $16,700 a year. In Fargo he would pay $410.

"Despite what the Legislature did this session, we figure workers' compensation rates would still be three times higher in Minnesota," said Curtis Aanenson, vice president of Old Dutch Foods, Inc., which is moving one of its potato chip plants from East Grand Forks to Grand Forks. Old Dutch plans to double its workforce in North Dakota.

"We would like to have stayed in Minnesota," Aanenson said. "If you're going to move to Alabama and Mississippi it seems like such a big move. But going just across the river is relatively easy."

Old Dutch is the 27th business that has closed in East Grand Forks in the last five years. Eleven of those have moved to North Dakota.

"For a town our size, we should have three or four times the business," said Don Schneider, the East Grand Forks community development coordinator. "It feels bad."

North Dakota's official attitude to the plight of the Minnesota border towns could be symbolized by the shrug of a shoulder. After all, the state has always felt like a colony of Minnesota, particularly of the banks and grain companies of the Twin Cities.

"We've been shipping truckloads of money to Minnesota for generations," said North Dakota Gov. Allen Olson, who led a business recruiting mission to the Twin Cities earlier this month and who campaigned on improving his state's business prospecting. "Minnesota is good fishing, and I'm not talking only about fish."

Bob Everson, director of Fargo's industrial development corporation, is more sympathetic. "What Minnesota is doing to its business is nothing short of slaughter," he said. "Sure, Moorhead companies are coming over here, but we wouldn't think of recruiting them. This is a family affair."

It may be more of a family affair if the efforts of Moorhead and the other border towns fail to ease disparities. Most do not give much credence to the notion that Moorhead would actually try to secede from Minnesota, but answers to such questions are often left dangling and people recall the mid '50s when a flood control project changed the course of the Red River and a small part of Moorhead suddenly became Fargo.

"I love Minnesota," said Moorhead's Mayor Lanning. "I'm not ready to bail out yet. But remember that North Dakota once got a piece of Moorhead, and . . ."

[From the Minneapolis Tribune, May 31, 1981]

LON ARNHOLD/FARGO

"I lived in Moorhead for six months. Then I moved across the river and gave myself a raise," Lon Arnhold said. Arnhold, originally from St. Cloud, figures he was saving $90 a month when he moved five years ago and many times that amount now.

"If I had a real choice, I'd live in Moorhead," he said. "It's a prettier town. My loyalties are with Minnesota. I fish there. I went to high school and college there. But all the business is in Fargo."

Arnhold is 24 and vice president of Kendeco Supply Co., a distributer of specialty tools. In 1979, Kendeco had bought a tool company in Moorhead and consolidated its operations across the river in North Dakota. The reason? It's a familiar one.

TOM HOLTGREWE/MOORHEAD

"I could save $500 a month if I moved to Fargo," said Tom Holtgrewe, "but I'm not going to do it. Moorhead needs quality people these days and I'm going to stay and see what I can do to make some changes."

Holtgrewe, 37, is a partner in a Fargo accounting firm. He has lived in Moorhead all his life and although 90 percent of his fees come from North Dakota clients, he is, of course, taxed as a Minnesotan.

"Some of us are stubborn," he said. "My neighbor could save about $400 a month but she says it's worth paying extra to live in Minnesota. They say there's going to be tumbleweeds blowing down the main street of Moorhead. I don't buy that story. We've got too much to lose."

TECHNICAL APPENDIX

INCOME TRANSFER

BASELINE YEAR

The Federal Reserve report (referred to as the Impact Study) is based on 1978 data. But between 1978 and 1980 real oil prices nearly doubled, substantially increasing the outflow of energy dollars from Minnesota. In addition, decontrol of oil and gas prices between 1980 and 1985 will push prices higher, aggravating even further the income transfer problem. As shown in Tables 1, 2, 3 and 4 the Energy Agency estimates that Minnesota's annual payments for primary energy materials rose from $2,336 million in 1978 to $3,627 million in 1980, and are likely to rise to at least $4,567 million in 1985. (For consistency, the 1978 data is based on the Energy Agency's data sources. Although the energy consumption data are somewhat lower than those used in the Impact Study, the end results-deficit as a % of personal income - are reasonably consistent with the Impact Studies).

By ignoring the 1979-80 energy price hikes and the decontrol of oil and gas prices between 1980 and 1985, the Impact Study seriously underestimates the size of the income transfer. Thus, the starting point of the analysis, the calculation of the energy deficit, is understated by ignoring recent historical facts.

The decontrol of oil and natural gas prices will contribute to a significant increase in the deficit between 1980 and 1985. The Energy Agency's projections of 1985 delivered fuel prices, fuel demand and the deficit are shown in Table 4. While it is always possible to debate forecasts, the Energy Agency believes these forecasts are conservative because they are based on the assumption that the phased, partial decontrol of natural gas

Table 1

1972 Consumption of and Payments for Primary Energy Materials in Minnesota (1978 Dollars)

	Consumption	Delivered Price	Gross Payment
Coal	175 tBtu	$ .62/mmBtu	$108 million
Uranium	38 tBtu	.25/mmBtu	10
Natural Gas	362.6 bcf	.52/mcf	189
Crude Oil	68.5 mmbbls	5.45/bbl	373
Refined Products	45.7 mmbbls	13.44/bbl	614
	Total Deficit		$1,294 million
	Total Minnesota Personal Income		25,659
	Deficit as a % of Personal Income		5.0%

tBtu = tillion Btu
mmBtu = million Btu
bcf = billion cubic feet
mcf = thousand cubic feet
mmbbls = million barrels
bbl = barrel
mmtons = million tons

Table 2

1978 Consumption of and Payments for Primary Energy Materials in Minnesota (1978 Dollars)

	Consumption	Delivered Price	Gross Payment
Coal	250.8 tBtu	$ .89/mmBtu	$222 million
Uranium	126.6 tBtu	.31/mmBtu	39
Natural Gas	309.6 bcf	1.45/mcf	449
Crude Oil	78.8 mmbbls	12.35/bbl	974
Refined Products	37.1 mmbbls	17.56/bbl	652
	Total Deficit		$ 2,336 million
	Total Minnesota Personal Income		31,266
	Deficit as a % of Personal Income		7.5%

tBtu = trillion Btu
mmBtu = million Btu
bcf = billion cubic feet
mcf = thousand cubic feet
mmbbls = million barrels
bbl = barrel

Table 3
1980 Consumption of and Payments for Primary Energy Materials in Minnesota
(1978 Dollars)

	Consumption	Delivered Price	Gross Payment
Coal	322 tBtu	$ 1.01/mm Btu	$ 326 million
Uranium	122 tBtu	.37/mm Btu	41
Natural Gas	277 bcf	1.90/mcf	526
Crude Oil	55 mmbbls	23.57/bbl	1,296
Refined Products	45 mmbbls	31.96/bbl	1,438
	Total Deficit		$3,627 million
	Total Minnesota Personal Income		$32,498 million
	Deficit as a % of Personal Income		11.2%

Table 4
Projected 1985 Consumption of and Payments for Primary Energy Materials in Minnesota
(1978 Dollars)

	Consumption[1]	Delivered[2] Price	Gross Payment
Coal	418 tBtu	$ 1.04/mmBtu	$ 435 million
Uranium	119 tBtu	.37/mmBtu	44
Natural Gas	282 bcf	2.92/mcf	823
Crude Oil	55 mmbbls	31.02/bbl	1,644
Refined Products	43 mmbbls	37.70/bbl	1,621
	Total Deficit		$4,567 million
	Total Minnesota Personal Income		$36,800
	Deficit as a % of Personal Income		12.4 %

[1] 1980 Energy Policy and Conservation Biennial Report, Minnesota Energy Agency.

[2] Minnesota Energy Agency, Spring 1981.

required in the Natural Gas Policy Act will occur instead of the accelerated decontrol which the current federal administration is pursuing. A study of the impacts of rising energy prices should at least use current data and should also attempt to look at the future. Doing so reveals a significantly higher deficit as a percentage of personal income (11.2% in 1980 and 12.4% in 1985, compared to about 8% in 1978).

METHODOLOGY AND ASSUMPTIONS FOR CALCULATION OF BASELINE INCOME TRANSFER

The effort to trace the distribution of Minnesota's energy payments, which was attempted in the Impact Study, is a useful avenue for analysis of the impacts of rising energy prices. However, methodological flaws and unwarranted assumptions in the Impact Study resulted in a conclusion which significantly underestimates the flow of energy dollars from Minnesota. While the U.S. economy is so complex and dynamic that it is impossible to trace the flow of energy dollars in a complete and final way, the Energy Agency believes that the Impact Study was sufficiently flawed to warrant the following recalculation of income transfer for Minnesota's most important energy sources, oil and gas.

Before presenting a recalculation of income distribution resulting from oil and gas payments in 1978 and 1980, these energy payments must be broken down into components.

Payment Components

The average cost of a barrel of domestic crude oil delivered to refineries (the "delivered price") was $10.61 in 1978 and $20.33 in 1980. The 1978 and 1980 payments are broken down into the components used in the Impact Study in Table 5, columns (1) and (3), respectively. These breakdowns are based on the following:

1) Wellhead price and delivered price were as reported by the Department of Energy, Monthly Energy Review, June 1981. U.S. average costs are used here because the effect of the entitlements program (described on page 3 of this appendix) was to make the delivered cost of crude oil the same throughout the country.

2) Transportation costs were calculated as delivered price minus wellhead price.
3) State and federal taxes in 1978 were 6% and 4.1%, repectively of the wellhead price, consistent with the Impact Study.[1] 1980 state and federal taxes were updated according to Texas Energy and Natural Resources Advisory Council, Texas Energy Outlook, 1980-2000, Tables 3.1 - 4 and 3.5 - 2.
4) Royalty was 12.5% of the wellhead price, consistent with the Impact Study.[2]
5) Payroll was $1.19 per barrel in 1978, consistent with the Impact Study[3], and was assumed to remain constant in real terms between 1978 and 1980.
6) Stockholders return was defined as dividends to stockholders plus income applicable to minority interests. For a group of 26 major oil companies, these parameters totalled 2.2% of total revenues in both 1978 and 1979.[4]

Dividends clearly should be assigned to stockholders, but the Impact Study appears to have also assigned not only retained earnings which were reinvested in the business but depreciation as well: "return to stockholders" is defined on page 3 of Impact Study Appendix A as "after tax profits plus capital consumption allowances."

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[1] Impact Study Appendix A, page 9.
[2] Ibid.
[3] Ibid.
[4] Patrick J. Keenan, Financial Analysis of a Group of Petroleum Companies, Section 2, Table 4, page 27.

Capital consumption allowance is a tax write-off provision which allows the oil company to pay less taxes because of the value of capital equipment decreases as the equipment gets older. Therefore, capital consumption allowances should not be considered an income to stockholders.

Retained energy earnings which are reinvested in the business might be considered a return to stockholders because those expenditures should increase the value of the stock, thus increasing the stockholders' wealth "on paper." However, the rest of the payment flows examined in the Impact Study were the immediate flows of cash to the various parties having a claim to these payments: workers, royalty holders, governments and producers of oil production inputs. A consistent approach would require the assignment of reinvested earnings to the "other inputs" category, since these reivestested earnings in reality go to producers of equipment and other inputs to oil production. This approach will be used here, since it more accurately reflects the actual transactions of dollars which occur in any given year.

Therefore, stockholders return was calculated as 2.2% of the wellhead value of the oil.

7) "Other inputs" was the residual.

The delivered price of a thousand cubic feet (mcf) of domestic natural gas was $1.39 in 1978 and $1.75 in 1980. The 1978 and 1980 payments are broken down into the components used in the Impact Study in Table 6, columns (1) and (3) respectively. These breakdowns were based on the following:

1) Wellhead prices and delivered prices were based on Northern Natural Gas, Form 2 Annual Reports, Northern States Power Company data and Minnegasco data.
2) Transportation costs were calculated as delivered price minus wellhead price.
3) State severance and federal taxes were 7% and 3%, respectively, of the wellhead price, consistent with the Impact Study.[1]
4) Royalty was 13% of the wellhead price, consistent with the Impact Study.[2]
5) Payroll was assumed to be $.05 per mcf in 1978, consistent with the Impact Study,[3] and was assumed to remain constant in real terms between 1978 and 1980.
6) Stockholders return was assumed to be the same percentage of the wellhead value as for oil. As discussed above, this was determined to be 2.2% of wellhead value.
7) "Other inputs" was the residual.

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[1] Impact Study, Appendix A, page 7.
[2] Ibid.
[3] Ibid.

Table 5

Revised Distribution of Payments For a Barrel of Domestic Crude Oil, 1978 and 1980
(1978 Dollars)

	(1)	(2)	(3)	(4)	(5)	(6)
		1978 Distribution			1980 Distribution	
Payment Type	1978 Amount	Producing State	Neutral	1980 Amount	Producing State	Neutral
payroll	$1.19	$1.19		$1.19	$1.19	
other inputs	5.57	3.90	$1.67	9.64	6.75	2.89
state severance tax	.54	.54		1.07	1.07	
royalty	1.13	.85	.28	2.23	1.67	.56
stockholders return	.20	.02	.18	.39	.04	.35
federal taxes	.37	—	.37	3.26	—	3.26
wellhead price	9.00	6.50	2.50	17.78	10.72	7.06
pipeline transportation from wellhead	1.61	.48	1.13	2.55	.77	1.78
delivered price	10.61	6.98 (66%)	3.63 (34%)	20.33	11.49 (57%)	8.84 (43%)

Table 6

Revised Distribution of Payments for a Thousand Cubic Feet of Domestic Natural Gas, 1978 and 1980
(1978 Dollars)

	(1)	(2)	(3)	(4)	(5)	(6)
		1978 Distribution			1980 Distribution	
Payment Type	1978 Amount	Producing State	Neutral	1980 Amount	Producing State	Neutral
payroll	$.05	$.05		$.05	$.05	
other inputs	.50	.35	.15	.78	.55	.23
state severance tax	.05	.05		.08	.08	
royalty	.10	.08	.02	.14	.11	.03
stockholders return	.02	.01	.01	.02	.01	.01
federal taxes	.02	—	.02	.03	—	.03
wellhead price	.74	.54	.20	1.10	.80	.30
pipeline transportation from wellhead	.65	.20	.45	.65	.20	.45
delivered price	1.39	.74	.65	1.75	1.00	.75
		(53%)	(47%)		(57%)	(43%)

Distribution of Payments to Income Categories

One of the key assumptions in the Impact Study is that Minnesotans share significantly in income from energy production via federal taxes, royalty payments, energy company dividends and production of goods and services used in energy production, transportation and processing. To the extent that Minnesotans do share equally in these incomes from energy production, that income is considered "neutral".

In the Impact Study, energy payments which clearly stayed in the producing state were assigned to a second income category, "producing state." Payments which could not be clearly assigned to either the "neutral" or "producing state" categories were assigned to a third category, "mixed." A final category, "foreign," identifies payments leaving the U.S. to pay for imported oil or natural gas.

The "mixed" category was handled with some sleight-of-hand in the Impact Study. With the categories defined as stated, the addition of the "mixed" share to the "producing state" portion would have been a logical way to calculate the upper end of a range of income flowing to the producing state. Yet, when the conclusion of the section on "Minnesota Energy Deficit Viewed as Income Transfer" was stated on page 10 of the Impact Study, the mixed category was ignored.

In the following recalculation of the income distribution from oil and gas payments, income shares which were designated "mixed" in the Impact Study will be separated into the "producing state" or "neutral" categories based on available data.

How should each of the oil and gas payment components be assigned to the income categories? In the Impact Study, the following assignments were made for all fuels:

Producing State	Mixed	Neutral	Foreign
All payroll	All royalty	All pipeline transportation	All entitlement payments
All severance tax	33.3% of other inputs	All federal taxes	
33.3% of other inputs		33.3% of other inputs	
10% of refinery value-added		All of stockholder return	
		90% of refinery value-added	

Based on the data and methodological considerations discussed below, the Energy Agency has modified the assignments for oil and gas as follows:

Producing State	Neutral	Foreign
All payroll	30% of other inputs	85% of payments for imports
All severance tax	25% of royalty	
70% of other inputs	91% of stockholder return (oil)	
75% of royalty	73% of stockholder return (gas)	
9% of stockholder return (oil)	All federal taxes	
27% of stockholder return (gas)	70% of oil and gas transportation by pipeline	
30% of oil and gas transportation	72% of refinery value-added	
28% of refinery value-added	15% of payments for imports	

Other Inputs

Data from an input-output model of the Texas economy[3] indicates that, of payments made by the oil and gas production industries other than payroll, taxes, royalties or depreciation, almost 70% were to in-state companies, while 30% were to out-of-state companies. Although this breakdown is for 1967, it is likely that it is still roughly accurate or, if anything, it has shifted toward a smaller out-of-state percentage. Economics favor the establishment or expansion of energy-production-related businesses in or near to the to the energy produciton area.

In view of this data on the cost structure of the oil and gas industry in a major oil and gas production state, it is more appropriate to assume that 70% of "other inputs" stays in the producing state, while 30% is neutral, rather than 1/3 each to "producing state," "mixed" and "neutral," as assumed in the Impact Study.

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[3] Herbert W. Grubb, Ph. D., The Structure of the Texas Economy, Appendix A, Table 2, page 108.

Royalty

While the geographical distribution of royalty payments for energy resources is not entirely clear, available evidence indicates that Minnesotans receive a miniscule portion of these payments, while energy-producing states receive the bulk of them.

The major oil and gas producing states' shares of all royalty income paid to individuals or state governments in 1978 and each state's share of total U.S. oil and gas production in 1978 are shown in Table 7. (Note that these data are for 1973, and therefore do not include the substantial oil price hike of 1979, which would increase the disparity between Minnesota and the energy-producing states.)

If Minnesota shared royalty income equally with other states (i.e., 100% of royalty income would be "neutral"), Minnesotans would receive about 2% of the total, or $57 million. However, Minnesotans received only $6 million, or 11% of royalty income to the "neutral" category, with the remainder to "producing state." Alternatively, the sum of the oil and gas producing states' shares of all royalty income (about 75%) could be assigned to "producing state," with the remainder to "neutral." Although other minerals might be produced in the energy producing states, energy resources undoubtedly are responsible for the majority of the royalty payments. Therefore, it is likely that at least 75% of oil and gas royalty payments to individuals go to citizens of the energy producing state.

Since Minnesota produces significant quantities of taconite and iron ore, two commodities on which royalties would be paid, it

Table 7

Geographical Distribution of Royalty Payments to Individuals and States in 1978

	Royalty Payments to Individuals[1] (million $)	% of Total Individual Royalties	Royalty Payments to States[2] (million $)	% of Total State Royalties	Royalty Payments to Individuals and States (million $)	% of Total Payments to Individuals and States	% of Total U.S. Production of Oil and Gas[3]
Texas	1,000	39.1	373	30.5	1,373	36.3	24.9
Louisiana	345	13.5	286	23.4	631	16.7	20.0
Oklahoma	316	12.5	26	2.1	342	9.0	5.2
California	144	5.6	97	7.9	241	6.4	4.4
New Mexico	45	1.7	128	10.5	143	3.8	5.2
Alaska	0.4	0.0	130	10.7	130	3.4	5.3
Total Oil and Gas Producing States	1,850	72.4	1,040	85.1	2,860	75.6	65.0
Minnesota	4	0.2	2	0.2	6	0.2	0.0

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[1] Internal Revenue Service, 1978 Statistics of Income, Individual Income Tax Returns, Table 5.1, page 132.

[2] U.S. Bureau of the Census, State Government Finances (annual series.)

[3] Energy Information Administration, Annual Petroleum Statements and Natural Gas Annuals.

is likely that the bulk of the royalty payments to Minnesota individuals were for taconite or iron ore, not energy resources. Thus, regarding individual and state income, it is probable that considerably less than 11% is neutral.

However, data on royalty payments to corporations are not available, and these payments may be more in Minnesota's favor than is the case with individual royalties.

In view of these uncertainties, the more conservative assumption will be used in the recalculation of income shares from oil and gas payments: Twenty-five percent of royalty payments are neutral, with 75% assigned to the producing state.

Stockholder Return

In the Impact Study it was assumed that all oil production profits were owned by publicly-held (common stock) corporations, and that Minnesotans are equally represented as stockholders of these corporations as are residents of other states.

However, not all oil and gas companies are publicly-owned and therefore not all of these companies have stockholders. About 10% of oil production in 1980 was by privately-held producers[4], while 30% of the natural gas used in Minnesota was from privately-held producers.[5] About 91% of the oil and 90% of the gas produced by privately-held companies was produced by companies located in producing states.[6] Thus, if we accept the assumption that actual stockholder return is distributed in a geographically even manner, 9% of oil production "stockholder return" should be assigned to "producing state," with 91% to "neutral," while the percentages for natural gas should be 27% and 83% respectively. To the extent that actual stockholder return is not distributed neutrally, the percentage of "stockholder return" assigned to the neutral category would be lower. The assumptions made here will result in a larger "neutral" component than may actually exist.

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[4] "Leading U.S. Independent Producers," Oil Daily, July 13, 1981.

[5] Tom Jetton, Northern Natural Gas Company, personal communication, July 14, 1981.

[6] "Leading U.S. Independent Producers," Oil Daily, July 13, 1981.

Transportation

The cost of transporting crude oil to Minnesota refineries and the cost of transportation of natural gas was totally assigned to the "neutral" category in the Impact Study. However, the vast majority of oil and gas pipeline miles are concentrated in the energy-producing states,[7] so a significant part of operation and maintenance costs for these pipelines goes to these states. To reflect this, the Energy Agency reassigned 30% of oil and gas transportation costs to "producing state" and 70% to "neutral."

The portions of oil and gas transportation payments that are actually "neutral" are probably considerably less than 70%. However, it was intended that the assumptions used here be conservative, i.e. understate the income transfer to producing states.

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[7] Visual inspection of maps: "Major Natural Gas Pipelines" by the Federal Energy Regulatory Commission; and "Crude Oil Pipelines in the United States and Canada" by Oil and Gas Journal.

Final Calculation of Income Distribution for Domestic Oil and Gas

Based on the above methodological revisions, the distribution of income from payment for a barrel of domestic crude oil in 1978 and 1980 is calculated as shown in Table 5. In 1978, 64% of Minnesota's payments for domestic crude oil went to the producing state, while at most 36% of the payments were "neutral." In 1980, 55% of Minnesota's payments for domestic crude oil went to the producing state, and at most 45% were "neutral." (Although substantial increases in producing state income occurred between 1978 and 1980, the enactment of the federal "windfall profits" tax resulted in a larger "neutral" percentage in 1980 than in 1978.)

In contrast, the Impact Study calculations yielded a distribution for 1978 of 32% "producing state," 11% "mixed" and 57% "neutral."[7A]

Based on the above methodological revisions, the distribution of income from payment for a thousand cubic feet of domestic natural gas in 1978 and 1980 is calculated as shown in Table 6. In 1978, 53% of Minnesota's payments for domestic natural gas went to the producing state, while at most 47% of the payments were "neutral." In 1980, 55% of Minnesota's payments for domestic natural gas went to the producing state, and at most 45% were "neutral."

In contrast, the Impact Study calculations yielded a distribution for 1978 of 23% "producing state," 25% "mixed" and 52% "neutral."[7B]

[7A] Impact Study Appendix A, page 10

[7B] Impact Study Appendix A, page 8.

Oil Imports and Final Crude Oil Calculation

The Impact Study underestimated income transfer from Minnesota to foreign countries because it did not reflect the fact that 44% of U.S. crude oil requirements were met with foreign imports in 1978, and 40% in 1980. In 1978, foreign oil was purchased at an average delivered price of $14.57 per barrel, while domestic oil cost an average of only $10.61 per barrel. In 1980, foreign oil was purchased at an average delivered price of $28.43 per barrel, while domestic crude cost an average of only $20.33 per barrel.

Because some states, like Minnesota, purchase more high-priced foreign oil than the national average, the federal government instituted the entitlements program to equalize the average cost of oil faced by refiners: refiners purchasing high proportions of cheap domestic oil were required to pay "entitlements" which were used to reduce the effective price of foreign oil and expensive new domestic oil to refiners who are highly dependent on these types of oil. Therefore, the composite price of all crude to Minnesota refiners should be about the national average: $12.35 per barrel in 1978 and $23.57 per barrel in 1980. Thus, while in 1978 Minnesota imported 79% of its crude oil from Canada or other foreign sources, entitlement payments to Minnesota refiners brought Minnesota's effective crude oil import level down to the national average, 44%.

Although the entitlements program was in effect in both 1978 and 1980, the program was eliminated in January 1981 in conjunction with the decontrol of oil prices.

How much of the payments for Canadian oil (and gas) come back to U.S. energy companies? At most, 50% of Canadian oil and gas production was owned by American companies in 1978.[8] However, the difference between the export price of Canadian oil and the allowed wellhead price is taxed away by the Canadian government.[9] After deduction of the export tax, royalty payments, (presumably to Canadians) and operating costs, only about 30% of the export price is available to the oil companies.[10] Therefore, at most 15% (30% of export price x 50% U.S. ownership) of total payments for Canadian oil came back to the U.S. in the form of production inputs or profits.

Although oil and gas producing states in the U.S. tend to dominate U.S. production of goods used in oil and gas production, we will be conservative here and assign all of this 15% to the "neutral" category.

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[8] According to The National Energy Program, 1980, Energy, Mines and Resources Canada, of the top 25 oil companies in Canada in 1978, 17 are more than 50% foreign (U.S.) owned. These 17 companies are responsible for 72% of Canadian oil and gas production. The average level of foreign ownership is probably skewed toward the lower end of the 50-100% range. Thus, the average level of foreign ownership is probably no more than 70%. Therefore, the maximum overall foreign ownership level is 70% x 72% = 50%.

[9] See The National Energy Program, 1980, Energy, Mines and Resources Canada, page 36.

[10] Based on data from The National Energy Program, 1980, Energy, Mines and Resources Canada, page 93.

How much of the payments for OPEC and other non-Canadian foreign oil flows to American energy companies through increased profits and sale of production inputs?

The data necessary to fully answer this question have not been found. However, because of nationalization of oil production, the profit role of American companies is probably quite small. And since actual production costs of OPEC oil are very low (because the oil is produced from old, cheap wells), the production inputs role would also be low. 15% would be a reasonable estimate of the maximum portion of non-Canadian foreign payments which comes back to the U.S. as "neutral" payments. This conservative assumption will be used in the following calculations.

1978

Payments to foreign crude oil suppliers for 1978 can be calculated as follows. Of Minnesota's total 1978 crude oil consumption of 78.8 million barrels, in effect 44%, or about 34.7 million barrels, was imported from foreign sources. The FOB cost of imported oil averaged $13.67 per barrel in 1978.[11] (The FOB cost excludes all costs related to transportation and insurance.) In view of the above discussion regarding the potential return of 15% of payments for imported crude, the net payment to foreign sources in 1978, excluding transportation, was at least 34.7 million barrels x $13.67 per barrel x 85% = $403 million.

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[11] Based on data from Energy Information Administration, Monthly Energy Review, June 1981.

The cost of transportation and insurance for imported oil averaged $.90 per barrel in 1978.[11A] This includes tanker transportation and related insurance for overseas oil as well as pipeline transportation from the wellhead (for Canadian oil) or from the port (for other foreign crude coming in from the Gulf Coast). Considering the various costs represented by this average of $.90 per barrel, a reasonable distribution of the payments is 50% foreign, 10% producing state and 40% neutral. Therefore, the total costs of foreign oil in 1978 can be summarized as follows:

	per barrel($)	total cost (million$)	Distribution (million $) Foreign	Producing State	Neutral
FOB Cost	13.67	474	403		71
Transportation	.90	31	16	3	12
	14.57	506	419	3	84
			(83%)	(0%)	(17%)

Note: numbers may not add due to rounding

Domestic oil made up, in effect, 56% of Minnesota's crude oil supply, and cost an average of $10.61 per barrel, including pipeline transportation. Total costs for domestic crude supply in 1978 were therefore 44.13 million barrels x $10.61 per barrel = $468 million. We have already established in Table 5 that 64% of payments for domestic crude in 1978 were distributed to the producing state and at most 36% were neutral. Therefore, the distribution of all crude oil payments in 1978 were as shown below.

[11A] Ibid.

1978 Crude Oil Income Distribution

Category	Payments in million $ Domestic	Foreign	Total	Average payment per average barrel($)
Producing State	309	3	312(32%)	3.95
Foreign		419	419	5.31
Neutral	159	84	243(25%)	3.09
	468	506	974	12.35

1980

Payments to foreign crude oil suppliers for 1980 can be calculated as follows. Of Minnesota's total 1980 crude oil consumption of 55 million barrels, in effect 40%, or about 22 million barrels, was imported from foreign sources. The FOB cost of imported oil averaged $27.37 per barrel in 1980.[12] In view of the above discussion regarding the potential return of 15% of payments for imported crude, the net payment to foreign sources in 1978, excluding transportation, was at least 22 million barrels x $27.37 per barrel x 85% = $512 million.

The cost of transportation and insurance for imported oil averaged $1.06 per barrel in 1980.[12A] This includes tanker transportation and related insurance for overseas oil as well as pipeline transportation from the wellhead (for Canadian oil) or from the port (for other foreign crude coming in from the Gulf Coast). As discussed above, a reasonable distribution of the payments would be 50% foreign, 10% producing state and 40% neutral. Therefore, the total costs of foreign oil in 1980 can be summarized as follows:

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[12] Based on data from Energy Information Administration, Monthly Energy Review.

[12A] Ibid.

			Distribution (million $)		
	per barrel($)	total cost (million$)	Foreign	Producing State	Neutral
FOB Cost	27.37	602	512		90
Transportation	1.06	23	12	2	9
	28.43	625	524	2	99
			(84%)	(0%)	(16%)

Note: numbers may not add due to rounding

Domestic oil made up, in effect, 60% of Minnesota's crude oil supply, and cost an average $20.33 per barrel, including pipeline transportation. Total costs for domestic crude supply in 1980 was therefore 33 million barrels x $20.33 per barrel = $671 million. We have already established in Table 5 that 55% of payments for domestic crude in 1980 were distributed to the producing stated and 45% were neutral. Therefore, the distribution of all crude oil payments in 1980 were:

1980 Crude Oil Income Distribution

Category	Domestic	Foreign	Total	Payment per average barrel ($)
Producing State	382	2	384(30%)	7.07
Foreign		524	524(40%)	9.43
Neutral	289	99	388(30%)	7.07
	671	625	1,296	23.57

Refined Oil Products

Income distribution for refined petroleum products in 1978 can be calculated as follows. In 1978, 60% of Minnesota's total petroleum was supplied by crude oil refined in Minnesota, and 40% was supplied by imports of petroleum products refined outside Minnesota. The payment components for crude oil shown in Table 5 are also applicable to refined products, with the addition of a payment of $5.21 per barrel for refinery value-added.

In the Impact Study, 10% of refinery value-added was assigned to the producing state, while 90% was considered neutral. However, Texas is responsible for 28% of all petroleum refining in the U.S. In view of this indication of the importance of producing state refining, the $5.21 in refinery value-added can be assigned this way: 28%, or $1.46, goes to the producing state, while 72%, or $3.75, is neutral. Since the weighted average crude oil price in 1978 was $12.35 per barrel, the addition of $5.21 per barrel refinery value added brings the total average price of refined product to $17.56, distributed as follows:

		Producing State	Foreign	Neutral
Average Delivered Crude Oil Price	12.35	3.95	5.31	3.09
Refinery Value Added	5.21	1.46		3.75
	17.56	5.41	5.31	6.84
		(31%)	(30%)	(39%)

Income distribution for refined petroleum products in 1980 can be calculated as follows. In 1980, 55% of Minnesota's total petroleum was supplied by crude oil refined in Minnesota, and 45% was supplied by imports of petroleum products refined outside Minnesota. The payment components for crude oil shown in Table 5 are also applicable to refined products, with the addition of a payment of $8.39 per barrel for refinery value-added.

As indicated above in the calculation for 1978, refinery value-added can be assigned this way: 28%, or $2.35 goes to the producing state, while 72%, or $6.04 is neutral. Since the weighted average crude oil price in 1980 was $23.57 per barrel, the addition of $8.39 per barrel refinery value added brings the total price of refined product to $31.96 per barrel, distributed as follows:

		Producing State	Foreign	Neutral
Average Delivered Crude oil Price	$23.57	7.07	9.43	7.07
Refinery Value Added	8.39	2.35		6.04
	$31.96	9.42	9.43	13.11
		(29%)	(30%)	(41%)

Final Calculation For Total Oil

Based on the above, income distribution for total petroleum (crude and refined product) payments in 1978 can be calculated as shown in Table 8.

Table 8
1978 Income Distribution From Oil Payments

	% of total supply	price per barrel($)	payments per barrel ($) producing state	foreign	neutral
Crude	60%	12.35	3.95	5.31	3.09
Refined Product	40%	17.56	5.41	5.31	6.84
Weighted Average Payment		14.44	4.53	5.31	4.60
1978 percentage distribution			31%	37%	32%

Thus, for every dollar spent on oil in Minnesota in 1978, 68¢ left the state, almost twice the 36% estimated in Chart 19 of the Impact Study.

Income distribution for total petroleum (crude and refined product) payments in 1980 can be calculated as shown in Table 9.

Table 9
1980 Income Distribution From Oil Payments

	% of total supply	price per barrel($)	payments per barrel ($) producing state	foreign	neutral
Crude	55%	23.57	7.07	9.43	7.07
Refined Product	45%	31.96	9.42	9.43	13.11
Weighted Average Payment		27.35	8.13	9.43	9.79
1980 percentage distribution			30%	34%	36%

Thus, for every dollar spent on oil in Minnesota in 1980, 64¢ left the state.

Gas Imports and Final Gas Calculation

In the above discussions the bases for revised assumptions regarding royalties, stockholder return, other inputs and transportation apply to natural gas as well as oil. The calculations in Table 6 reflect these revised assumptions.

In addition, the *Impact Study* did not reflect the fact that about 7% of Minnesota's natural gas was imported from Canada in both 1978 and 1980. (That percentage is likely to increase to 9.6% in 1981 and 21% in 1982.)

1978

Payments for Canadian natural gas in 1978 can be calculated as follows. Of Minnesota's total 1978 natural gas consumption of 309.6 billion cubic feet (bcf), 7%, or 211.7 million mcf (one mcf a thousand cubic feet), was imported from Canada at a wellhead price of $2.16 per mcf. As noted above, at most 15% of this payment can be considered neutral. Therefore, the total net payment to Canada for Canadian gas is 21.7 million mcf x $2.16 per mcf x 85% = $39.84 million. The "neutral" portion of the border payment for Canadian gas is 21.7 million mcf x $2.16 per mcf x 15% = $7 million.

The cost to transport a thousand cubic feet of Canadian natural gas by pipeline from the border was about $0.14 in 1978, so the cost of transporting 21.7 million mcf from the border was $0.14 per mcf x 21.7 million mcf = $3 million. All of that transportation payment will be considered "neutral".

Domestic gas made up 93% of Minnesota's total gas supply in 1978, and cost an average of $1.39 per mcf, including transportation. Total cost for domestic gas in 1978 was 287.93 million mcf x $1.39 per mcf = $400.22 million. We have already established in Table 6 that 53% of payments for domestic gas in 1978 were distributed to the producing state and 47% were neutral.

Based on the above data, the distribution of all natural gas payments in 1978 are shown in Table 10.

Table 10
1978 Natural Gas Income Distribution

	Payments in million $			
Category	Domestic	Canadian	Total	Payment per mcf
Producing State	208		208 (46%)	.67
Foreign		40	40 (9%)	.13
Neutral	192	10	202 (45%)	.65
	451	50	526	1.45

1980

Payments for Canadian natural gas in 1980 can be calculated as follows. Of Minnesota's total 1980 natural gas consumption of 277 bcf, 7%, or 19.4 million mcf, was imported from Canada at a wellhead price of $3.68 per bcf. As noted above, at most 15% of this payment can be considered neutral. Therefore, the total net payment to Canada for Canadian gas is 19.4 million mcf x $3.68 per mcf x 85% = $60.66 million. The "neutral" portion of the border payment for Canadian gas is 19.4 million mcf x $3.68 per mcf x 15% = $10.71 million.

The cost to transport a thousand cubic feet of Canadian natural gas by pipeline from the wellhead was about $0.17 in 1980, so the cost of transporting 19.4 million mcf from the border was $0.17 per mcf x 19.4 million mcf = $3 million. All of that transportation payment will be considered "neutral."

Domestic gas made up 93% of Minnesota's total gas supply in 1980 and cost an average of $1.75 per mcf, including transportation. Total costs for domestic gas in 1980 was 257.6 million mcf x $1.75 per mcf = $450.82 million. We have already established in Table 6 that 55% of payments for domestic gas in 1980 were distributed to the producing state and 45% were neutral.

Based on the above data, the distribution of all natural gas payments in 1980 are shown in Table 11.

Table 11
1980 Natural Gas Income Distribution

	Payments in million $			
Category	Domestic	Canadian	Total	Payment per mcf
Producing State	257		257(49%)	.93
Foreign		61	61 (12%)	.22
Neutral	194	14	208(40%)	.75
	451	75	526	1.90

Note: numbers may not add due to rounding

Coal and Uranium

The Impact Study methodology and assumptions in the calculation of income flows from coal and uranium payments were not examined in preparing this critique. Therefore, the income distribution percentages calculated in the Impact Study will be applied here to the Energy Agency's data on total payments for coal and uranium:

1978 Income Distribution For Coal and Uranium

	Total Payment (million 1978$)	Producing State	Mixed	Neutral
Coal	222	62 (28%)	31 (14%)	129 (58%)
Uranium	39	6 (16%)	4 (10%)	29 (74%)

1980 Income Distribution For Coal and Uranium

	Total Payment (million 1978$)	Producing State	Mixed	Neutral
Coal	326	91 (28%)	46 (14%)	189 (58%)
Uranium	41	7 (16%)	4 (10%)	30 (74%)

Total Income Distribution

The Impact Study estimated that, of a total primary energy payment of $2,588 million in 1978, 54% was "neutral," 13% "mixed," 24% "producing state" and 9% "foreign," for a total net transfer out of Minnesota of only 33%. Based on the Energy Agency's calculations presented above, the distributions of income from all Minnesota payments for primary energy materials in 1978 and 1980 are shown in Tables 12 and 13, respectively. The Energy Agency calculates minimum baseline income transfer of 60% in 1978 and 59% in 1980. Because the total energy payment rose significantly between 1978 and 1980, the total amount transferred also rose considerably.

Total Minnesota payments for primary energy materials in 1978 and 1980 and the Energy Agency's analysis of income transfer is shown in those years is shown in Figure 1, along with 1985 total payments as projected by the Energy Agency and the 1978 total payment and income transfer estimates used in the Impact Study. By using 1980 data and by correcting methodological errors and erroneous assumptions, the Energy Agency finds that Minnesota transfers $2.13 billion per year in energy payments out of the state, more than twice that estimated by the Federal Reserve Bank. This loss represented 6.6% of Minnesota personal income in 1980.

Although it has not been projected here, net income transfer in 1985 is likely to rise at least in proportion to the increase in total payment.

Table 12
1978 Distribution of Primary Energy Payments

	Total Payment (million 1978$)	Producing State	Foreign	Mixed	Neutral
Coal	222	62		31	129
Uranium	39	6		4	29
Natural Gas	450	208	40		202
Petroleum	1626	504	601	—	520
	2336	780	641	35	880
		(33%)	(27%)	(2%)	(38%)

Table 13
1980 Distribution of Primary Energy Payments

	Total Payment (million 1978$)	Producing State	Foreign	Mixed	Neutral
Coal	326	91		46	189
Uranium	41	7		4	30
Natural Gas	526	257	61		208
Petroleum	2734	820	930	—	984
	3627	1175	991	50	1411
		(32%)	(27%)	(1%)	(39%)

METHODOLOGY AND ASSUMPTIONS FOR CALCULATION OF INCOME TRANSFER DUE TO ENERGY PRICE INCREASE

Following the calculation of energy payment flows for 1978, the Federal Reserve Bank than attempted to address the question of the flow of payments resulting from an increase in the price of energy. In the Impact Study it was assumed that...

> "the 'rents' created by an externally generated price rise get captured largely by the claimants to ownership of produced minerals at the source. These include the producing firms, the royalty claimant, and various governments through taxes which tap directly into the incremental income flows of producer and royalty recipient, such as state severance taxes and federal income and windgall profits taxes. If a state corporate income tax also applies to the producing company, some additional part of the gain showing up in producer income would also be subject to capture by government authority."[13]

In the Impact Study the distribution of increased income resulting from energy price increases between 1972 and 1978 was calculated as follows. First, the total real increase in annual payments for primary energy materials between 1972 and 1978 was apportioned to each fuel according to the distribution of payments by fuel in 1978. Then, the payment increase for each fuel was apportioned as follows:

1. The percentage of the price at the wellhead or mine that is taken in state severance tax was assigned to "producing state."

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[13] Impact Study Technical Appendix A. page 14

2. The percentage of the price at the wellhead or mine that is paid for royalties was assigned to "mixed."
3. 90% of payments for foreign oil (which was assumed to be 40% of total oil supply) was assigned to "foreign."[14]
4. The remainder was assigned to "neutral," based on the assumption that the rest of the payment increase will be captured by energy company stockholders or the federal government.
5. There also were ad hoc adjustments for increased collection of state corporate income taxes.

Based on the above, the Impact Study estimated that annual energy payment increases due to the price rises between 1972 and 1978 were distributed as shown below.

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[14] The methodology employed by the Federal Reserve Bank to calculate the above figures conflicts with the methodology used by the Bank to compute the baseline (1978) distribution of energy payments. The explanation of the methodology used to calculate baseline payments, as discussed in the first full paragraph on page 10 of Impact Study Appendix A, conflicts both with the explanation of the methodology on pages 4 and 5 of the same Appendix and with the calculations shown on page 10. As noted above in the discussion of oil incomes, payments to foreign suppliers for total 1978 payments was figured in the Impact Study by simply assigning the entitlements payment portion of the total payment per barrel. The reasons why that procedure is incorrect have already been discussed. However, the Impact Study then switched its approach to estimate the distribution of payments due to price hikes : foreign payments were calculated by assuming that 40% of Minnesota's oil payments go to foreign counties, with 10% of those foreign payments considered "neutral."

Income Transfer Between 1972 and 1978
Due to Energy Price Hikes According to Impact Study

producing state	12%
foreign	25%
mixed	10%
neutral	53%
	total transfer is 37%

The Impact Study estimates are significantly flawed because they are based on two major incorrect assumptions:

1) all energy price hikes were externally generated and therefore not related to increases in the actual cost of production; and

2) as a result of the first assumption, all increased revenues after royalties and taxes are captured by stockholders.

However, examination of actual increases in costs and revenues between 1972 and 1978 for a group of 26 major oil companies (Table 14) shows that operating costs consumed the bulk of the revenue increase. In other words, it became more expensive to find and produce oil. The last column in Table 14 shows how the data were used to break the 1972-78 oil payment increase into the components used in this study. In the following recalculation of income transfer for the 1972-78 period, these payment components were assigned to the income categories as previously discussed. For example, 12.5% of the oil payment increase was for royalties, and 75% of royalty payments went to the producing state, while 25% was rentral.

TABLE 14

Increases in Revenues and Costs of Oil Production,1972-1978

	Real Increase 1972-1978* (billions of 1978$)	% of Total Revenue Increase, 1972-78	Breakdown into Components	
Operating Costs	160.1	86.5%	Royalty Other Inputs	12.5% 73.9%
Taxes	16.4	8.9%	State Taxes Federal Taxes	5.3% 3.6%
Write-offs	4.2	2.3%	Other Inputs	4.1%
Reinvested in Business	3.4	1.8%		
Dividends	1.1	.6%	Stockholders	.6%
Total Revenue	185.1	100.0%		

*Patrick J. Keenan, Financial Analysis of a Group of Petroleum Companies, Section 1, Tables A and C, pages 22 and 23.

Natural gas payment increases were handled similarly: 13% was assigned to royalty, 7% to state taxes and 3% to federal taxes, as discussed above in the recalculation of baseline income transfer; 0.6% was assigned to stockholders; and the residual went to "other inputs."

Coal and uranium payment increases were distributed as assumed in the Impact Study.

Income distribution for the increase in total energy payments was allocated to each fuel according to that fuel's share of the total payment increase for 1972-78 (Table 15). Thus, the figures presented below reflect the fact that most of the energy payment increases were due to higher oil prices and, to a lesser extent, natural gas prices, rather than higher coal or uranium prices.

Using the above approach, the Energy Agency determined that increases in primary energy payments between 1972 and 1978 were distributed as shown in Table 16.

Table 15

Percentage Distribution by Fuel for Real Primary Energy Payment Increases, 1972-78, 1978-80 and 1980-85*

	% of 1972-78 Energy Payment Increase	% of 1978-80 Energy Payment Increase	% of 1980-85 Energy Payment Increase
Coal	6.4%	2.7%	0%
Uranium	.7%	0.5%	0%
Natural Gas	27.2%	8.7%	30.5%
Oil	65.7%	88.1%	69.5%
Foreign	43.3%	43.2%	9.5%
Domestic	22.4%	44.9%	60.0%

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*Calculated from data in Tables 1 - 4. Foreign/domestic breakdown for oil based on these prices per barrel of crude:

	1972	1978	1980	1985
Domestic	$5.58	$10.61	$20.33	$31.02
Foreign	$4.90	$14.57	$28.43	$31.02

Table 16

Income Transfer Between 1972 and 1978
Due to Energy Price Hikes According to Minnesota Energy

producing state	36%
foreign	37%
mixed	0%
rentral	27%

Thus, while the Federal Reserve Bank estimated that the annual income transfer over this period was 37% of total primary energy payments, the Energy Agency calculates that this percentage should be 73%, or almost twice that amount. Since total payments increased $1,042 million between 1972 and 1978, and the net income transfer was $1,402 million in 1978, income transfer in 1972 was about $641 million, or 50% of total payments in that year. The income transfer in 1972 represented 2.5% of Minnesota personal income in that year, $25,659 million (in 1978 dollars), as shown in Table 17.

Table 17

Changes in Energy Payments and Income Transfer, 1972-1985

Year	Total Primary Energy Payments (million 1978 $)	Net Income Transfer (million 1978 $)	Personal Income (million 1978 $	Net Income Transfer as a % of Personal Income
1972	1,294	641	25,659	2.5%
1978	2,336	1,402	31,266	4.5%
1980	3,627	2,140	32,496	6.6%
1985	4,567	2,676	36,800	7.3%

Income transfer due to price increases between 1978 and 1980 was calculated by the Energy Agency using the data presented in Tables 12 and 13. These data show that income transfer rose from $1,402 million in 1978 to $2,140 million in 1980, or from 4.5% of personal income to 6.6% (see Table 17). While 73% of the increase in energy payments between 1972 and 1978 was a net transfer out of Minnesota, the corresponding percentage for the 1978-1980 period was only 57%, largely due to an increase in "neutral" federal tax payments resulting from the implementation of the Windfall Profits Tax.

As discussed already, Minnesota's payments for primary energy materials will increase from $3,627 million to $4,567 million (see Tables 3 and 4), an increase of $940 million between 1980 and 1985. It was assumed that the percentage of those increased payments that is transferred out of Minnesota will be similar to that for the 1978-80 period. This assumption appears reasonable because operating costs and capital expenditures will go up in the 1980-85 period as new, less accessible oil is discovered and produced; at the same time, "neutral" Windfall Profits Tax payments will increase. The net result should be 57% of the payment increase, or $536 million out of $940 million, being transferred out of Minnesota. Thus, the total annual income transfer in 1985 is $2676 million, or 7.3% of 1985 personal income (see Table 17).

For the entire 1972-1985 period, Minnesota's primary energy payments are expected to increase by $3,273 million, with 62% of that total, or $2,035 million, being transferred out of Minnesota.

This $2,035 million represents 6.5% of average personal income during the 1972-1985 period. In contrast, the Federal Reserve Bank estimated that the 1972-1978 energy price increases resulted in 1.5% of personal income being transferred out of the state.

Some perspective on the impact of future oil price increases can be gained by noting that the Treasury Department estimates that, with decontrol of oil prices, "oil producing states will collect $127.6 billion in incremental revenue over the next decade as a result of the lifting of price controls on domestic oil..."[15]

	Revenue billions 1979-90
Alaska	$ 37.3
Texas	33.2
California	21.8
Louisiana	13.8
Wyoming	3.5
Oklahoma	3.1
New Mexico	1.5
Kansas	0.9
Other	12.6
Total	127.6

In comparison, the entire annual budget for the state of Minnesota was only 3.6 billion in fiscal year 1980. If the Minnesota state budget remained the same throughout the 1980's, Texans, for example, would collect almost as much in *additional* revenue due to decontrol of oil as the entire state government in Minnesota would spend in that period.

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[15] *Natural Journal*, December 22, 1979, pages 2137-2138.

Producing states are also revising their tax laws to increase their share of energy development. For example, "Alaska believes it's entitled to 30% of revenues from Prudhoe Bay production. Alaska has hiked its taxes affecting the oil and gas industry 12 times in 13 years. Most onerous of these was a major increase in 1978 of a separate accounting category which caused a fivefold swing in industry's tax liability there."[16]

In addition to enriching themselves through higher oil revenues, the major oil producing states also could qualify for higher payments under a variety of federal programs, including general revenue sharing that link federal aid to state tax receipts.[17]

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[16] Oil and Gas Journal, July 6, 1981, page 212.

[17] National Journal, December 22, 1979, pages 2137-2138 .

TOTAL ECONOMIC IMPACT

In the Impact Study the Federal Reserve Bank posed two questions:

1) How much of Minnesota's income is transferred to energy producers in other states or nations?
2) How serious a threat do rising energy prices pose to Minnesota's competitiveness in attracting business investment?

These questions should be answered together and should be related to the overall impacts on the state or regional economy. The Impact Study methodology did not do this, and therefore inadequately addressed total economic impact in two major ways.

IMPACTS OF INCOME TRANSFER

First, the Impact Study not only underestimated income transfer, as discussed above, but also dismissed the transfer as insignificant without making any attempt to assess the total economic impact of income transfer.

Rising energy prices result in more individual income being spent for energy. These increased payments come from both energy used directly in the home or car as well as from energy used indirectly in producing goods and services bought by conslumers. After paying directly and indirectly for the increased cost of energy, less income is available to be spent on local goods and services. In this way, the income loss is multiplied through the Minnesota economy. Lower demand for local goods and services results in lower Gross State Product (GSP), personal income and employment.

Transfer of Minnesota income to other states or nations reduces the funds available for investment in Minnesota businesses. As discussed above, only part of the energy payments transferred out of Minnesota are potentially "neutral", i.e., are potentially available to return as new investment funds. The loss of new investment funds further slows Minnesota economic growth.

Using a detailed model of the Minnesota economy, the Energy Agency estimated the impacts on the Minnesota economy in 1985 of both (1) reduced consumer purchasing power due to higher energy costs and (2) reduced investment funds generated within the economy due to income transfer. In the baseline scenario, d_1 in Table 18, it was assumed that there are no losses in consumer purchasing power nor any loss in investment funds due to rising energy prices. In scenario d_2f it is assumed that, while decreased personal income reduces purchases of local goods and services, 67% of Minnesota's payments for primary energy supplies are "neutral," i.e., they flow back to Minnesota as new investment funds, thus partially compensating for the reduced purchases of local goods and services. This 67% return of neutral dollars is consistent with the Impact Study,* which shows a baseline income transfer of only 33%. Gross State Product in 1985 is 3.4% lower than in the baseline case in scenario d_2f.

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*Technical Appendix A, page 13.

Scenario d_2M is similar to d_2F except that the Energy Agency's baseline estimate of neutral payments--41% (from Table 13)--was used to calculate the economic impacts: Gross State Product in 1985 is 4.1% lower than in the baseline scenario. Scenario d_2W reflects the full impact of reduced local purchases and lost investment funds, unmitigated by new investment, i.e. it is assumed that none of Minnesota's energy payments return as "neutral" investment funds. In this scenario, Gross State Product and personal income are 5.2% lower than in the baseline case, and 105,000 fewer jobs are available in Minnesota.

Table 18

Gross State Product, Personal Income, and Employment under Five Scenarios

Gross State Product (billion 1980 $)

	d_1	d_2f	d_2m	d_2w	d_2e
1980	50.0	50.0	50.0	50.0	50.0
1981	50.7	50.4	50.3	50.2	52.8
1982	52.8	52.1	52.0	51.8	55.7
1983	54.3	53.2	53.1	52.7	57.8
1984	56.0	54.6	54.4	53.9	59.8
1985	57.9	55.9	55.5	54.9	61.5
	Personal Income (billion 1980 $)				
1980	39.7	39.7	39.7	39.7	39.7
1981	40.1	39.9	39.8	39.7	41.2
1982	41.9	41.3	41.2	41.0	43.6
1983	43.0	42.2	42.0	41.7	45.2
1984	44.4	43.2	43.0	42.6	46.7
1985	45.8	44.2	43.9	43.4	48.0
	Employment (1000 workers)				
1980	1995	1995	1995	1995	1995
1981	2022	2007	2005	2001	2059
1982	2102	2073	2070	2064	2160
1983	2155	2113	2107	2098	2232
1984	2189	2134	2126	2113	2274
1985	2225	2149	2138	2120	2303

In summary, Table 18 indicates that rising energy prices will result in a level of Minnesota economic activity in 1985 which is 3.4% to 5.2% lower than would otherwise be the case.

The effects will take two forms:

1) reduced purchases of local goods and services; and

2) loss of investment funds due to income transfer.

It is most likely that rising energy prices will result in about 4% lower economic activity in 1985.

This lower economic activity will result in correspondingly lower state tax collections. Lower state tax revenues will force reductions in state services, increases in tax rates (which discourages business investment), or both.

While energy producing states will experience constraints on economic growth due to higher consumer energy bills, and thus fewer purchases of local goods and services, this effect will be mitigated by additional personal income and investment stimulated by energy income transfer.

Scenario d_2e in Table 18 shows what would happen if Minnesota was an energy-producing state. In this scenario it was assumed that, starting in 1981, Minnesota produces enough oil and gas to meet all of its needs for those fuels. In order to model this, the "other mining" sector of the economic model was allowed to grow to simulate the purchase patterns of the oil and gas production industry. Prices were the same as in the other scenarios. The result is that, if Minnesotans paid other Minnesotans for energy--thereby eliminating the energy income transfer the economic impacts of rising prices are completely counter-balanced.

REGIONAL COMPETITIVENESS IN A MACROECONOMIC CONTEXT

The Impact Study analysis of the competitive effects of rising energy prices was an extremely narrow study because it simply compared Minnesota and Louisiana as potential locations for an energy-intensive industrial plant. This narrow approach ignores not only the loss of investment funds due to income transfer, but more fundamentally, it completely ignores the critical question of the attractiveness of investment in various types of industries and the "boom" effect that energy development has had in the southern and western states. Thus, regional competitiveness should be viewed in a macroeconomic context, i.e., by looking at the total economy in states or regions, not just at a hypothetical decision by one industrial firm.

As the value of energy increases, the attractiveness of investment in the energy industries also rises. With a limited amount of total capital, there is competition for investment dollars. The energy industries and their support industries, and the geographical areas in which they are located, will tend to draw a disproportionate share of limited capital because of the higher rates of return they can offer. Table 19 shows rate on equity for industry groups represented in Minnesota, return on equity in the fuel industries and their support industries, and a composite return on equity for all industries. The return to investors in the energy industry in 1980 was about 60 percent higher than the average return. This is a strong stimulus to invest in energy, and thus invest in the energy-producing areas.

Table 19

RETURN ON COMMON EQUITY IN ENERGY AND NON-ENERGY INDUSTRIES, 1980*

Non-Energy Industries	
Banks & Bank Holding Companies	17.8
Building Materials	10.9
Electrical, Electronics	19.3
Food Processing	15.6
General Machinery	15.3
Instruments	15.4
Metals and Mining	18.1
Misc. Manufacturing	16.3
Non-Bank Financial	15.9
Office Equipment, Computers	19.2
Paper and Forest Products	12.6
Railroads	13.9
Retailing (Non-Food)	11.5
Special Machinery	7.8
Energy Industries	
Natural Resources (Fuel)	23.8
Oil Service and Supply	24.2
Utilities	12.9
All industries, composite	15.3

*From "Corporate Scoreboard," Business Week, March 16, 1981, pages 65-100.

In fact, during the 1970's capital spending grew 2½ times faster in the South and West than in the Northeast and Midwest.[19] Investment stimulates employment and personal income. Construction employment in the 1970's increased only 2.7% in the Northeast and Midwest, but jumped 55% in the South and West. Regional differences in manufacturing employment and personal income during the 1970's is shown in Table 20, which shows that during that decade real incomes grew more than twice as fast in the South and West than in the Northeast and Midwest.[20] An expanding economic base not only allows governments in energy-producing states to reduce or eliminate corporate taxes, but also allows the improvement of government services, such as roads and schools, thereby attracting more industries and skilled workers.

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[19] "America's Restructured Economy," Business Week, June 1, 1981.

[20] Ibid.

Table 20

Growth In The South And West Will Continue To Outpace Other Regions *

	Manufacturing employment		Real personal Income	
	1971-80	1981-90	1971-80	1981-90
Northeast & Midwest	-0.1%	0.6%	2.1%	2.4%
New England	1.3	0.7	2.4	2.5
Mid-Atlantic	-0/9	0	1.3	2.2
East North Central	-0.3	0.7	2.4	2.4
West North Central	1.7	2.1	3.3	2.8
South & West	2.4%	2.6%	4.5%	3.2%
South Atlantic	1.4	2.2	3.9	3.2
East South Central	1.3	2.8	3.9	3.8
West South Central	3.7	2.9	5.8	3.1
Mountain	4.8	3.4	5.7	3.8
Pacific	3.3	2.6	4.3	3.0
Total U.S	1.0%	1.6	3.3%	2.8%

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*"America's Restructed Economy," Business Week, June 1, 1981, page 64.

A study of the regional implications of policy scenarios for Project Independence[21] concluded that, given the mix of industries in various states,

> "For the most part, only the energy-producing states show higher earnings when the price of imported oil rises $4; and only the oil states show higher earnings - given multiplier effects - under al all-out effort for energy independence."

The trends in regional economic growth established in the 1970's are likely to continue, as indicated by the economic forecasts in Table 20. Manufacturing employment is expected to rise 2.6%/year in the South and West, and personal income at 3.2%/year. In the Northeast and Midwest, however, manufacturing employment will grow at only 0.6%/uear and personal income at 2.4%/year.

In summary, by focusing on a very narrow aspect of regional competitiveness rather than examining this issue in a macroeconomic context, the Impact Study completely missed a fundamental point, which can be expressed very simply: money flows to where the action is, and the action is in energy.

ASSESSMENT OF ECONOMIC IMPACT

A useful approach to assessment of the economic impact of rising energy prices would be an analysis of changes between 1972 and 1980 in the "terms of trade" of Minnesota and an energy producing state such as Texas. "Terms of trade" is an economic term referring to a comparison between the prices of products manufactured in a state and the costs of the materials, including energy, used to manufacture those products. If the prices of the products rise faster than the costs, the terms of trade have improved. If costs have risen more than product prices, the terms of trade have worsened.

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[21] A. David Sandoval and W. Michael McHugh, "Industry Mix and Sensitivity of State Economies to Energy Price and Policy Changes." International Regional Science Review, Volumes 1 & 2, Fall 1976, pages 56-73.

The impacts of the changes in terms of trade on Gross State Product, employment and personal income could then be analyzed.

LOCATION ANALYSIS

As discussed above, the Impact Study analysis of the impact of rising energy prices on the competitiveness of business investment in Minnesota was limited to a narrow study in which the costs of locating a typical energy intensive industrial plant in Minnesota were compared, in terms of rate of return, to the costs of locating the same plant in Lousiana. The conclusion of that study was that rising energy prices do not work significantly against Minnesota in this type of comparison. The reasons why this narrow type of study was inadequate to address the competitiveness issue have already been discussed. But even this narrow study was flawed in a number of ways.

BASE CASE DIFFERENCES IN RATES OF RETURN

The Impact Study considers only those changes in relative rates of return due to energy price increases over 1978 levels. Yet the base case differences between states would not be discounted by businesses making location decisions. The effects of the price hikes that have occurred since 1973 are still being felt and should be considered. In Table 7 of the Impact Study the rate of return in the base case for Louisiana (13.98%) is more than 7% higher than that for Minnesota (13.09%).

The importance of energy-related differences in rates of return to businesses making location decisions is difficult to ascertain, and will vary from case to case depending on the other factors involved. However, while many uncertain factors enter into businesses location decisions, the long term direction of energy costs is a certainty - only the magnitude of the increase is the question.

RETURN ON EXTRA INVESTMENT

Comparison of alternative investments via the internal rate of return method gererally do not stop with calculation of rates of return on total investment. The key calculation is that of return on the extra investment required in one alternative (due to energy costs, for example) compared with another.

Using data from the Impact Study, Table 21 shows that the Minnesota location requires an extra investment of $1.36 million. Since operating costs in Minnesota are also higher because of energy requirements, a given company's net revenues (revenues minus operating costs) are lower in Minnesota than in Louisiana. When the differences between the two alternative investments are considered, we find that the extra investment in Minnesota yields not an extra net revenue, but comparitively lower net revenues. Although the specific return on extra investment has not been calculated here, it is clear that the return on extra investment is negative (paying more initially to make less money later) - a very clear and strong count against a Minnesota location.

Table 21

Differences in Investment and Net Revenue For Industrial Plant Located in Minnesota Compared to Louisiana

	Minnesota	Louisiana	Extra Investment, Cost or Revenue in Minnesota
Capital Investment[1]	$34 million	$32.64 million	+$1.36 million
Operating Costs[2]	$25 million/year	$24.79 million/year	+$.21 million
Revenue[3]	$35 million/year	$35 million/year	
Net Revenue[4]	$10 million/year	$10.21 million/year	-$.21 million

[1] Table 5 of Impact Study.

[2] Table 6 of Impact Study.

[3] Impact Study Appendix B, page 2, section 1.2.1.

[4] Revenue minus operating costs.

ENERGY PRICE INCREASES

Using a 1978 baseline, it is inappropriate to use a 50% price increase to test the competitiveness of Minnesota businesses, as is done in Part III of the Impact Study. As shown in Table 22, recent history has already out-distanced that figure for distillate and residual fuel oils, and the weighted average price increase between 1978 and 1985 is projected to be 85%. The 1985 price projection is conservatively low because it is based on the phased, partially decontrol under current law, rather than the accelerated, complete decontrol being comtemplated by the current federal administration.

Table 22
Percent Change in Real Industrial Energy Prices

	Actual 1978-80	Projected 1978-85*	% of Minnesota Industrial Energy Use, 1978
Natural Gas	14.9	127.4	51.9
Distillate Fuel Oil	90.0	122.5	15.0
Residual Fuel Oil	79.3	155.2	
Electricity	-5.1	-5.5	14.3
Propane	30.8	53.8	.9
Coal	-5.8	8.3	17.9

Weighted average increase 1978-80: +19%
Weighted average increase 1978-85: +85%

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*Minnesota Energy Agency, July 2, 1981.

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STATE OF MINNESOTA
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August 20, 1981

The Honorable Dave Durenberger
United States Senate
Chairman, Subcommittee on
Intergovernmental Relations

Attention: Ruth Doerflein, Chief Clerk
Subcommittee on Intergovernmental Relations
Room 507, Carroll Arms Building
301 First Street, N.E.
Washington, D.C. 20510

Dear Senator Durenberger:

In response to your August 4th letter requesting clarification on what Minnesota mineral taxes are and how they work, I have prepared a summary describing each tax and its key characteristics. (Attachment I)

In addition, concerning your interest in Minnesota's approach to taxing copper-nickel I have attached a "Summary of Issues" that a Minnesota interagency working group, of which I was a participating member, developed for executive and legislative review and consideration. (Attachment II)

I will draw my oral statement to the subcommittee from the information I have attached.

Sincerely,

Dwight E. Lahti

Dwight E. Lahti
Minerals Tax Administrator

DEL:VP

Attachments

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ATTACHMENT I

SUMMARY OF MINNESOTA MINERAL TAXES AND HOW THEY WORK

There are fourteen taxes that apply either directly or indirectly to mining and/or minerals in Minnesota. The key characteristics of each tax are summarized in this attachment.

CONTENTS **Pages**

1. Taconite Production Tax. . . . . 1 - 4
2. Semi-Taconite Production Tax 5
3. Occupation Tax: Iron/Taconite . . . . 6 - 8
4. Sales and Use Tax. 8
5. Ad Valorem Tax on Unmined Natural Ore . . . . . 9 - 10
6. Royalty Tax: Iron/Taconite. . . . . 11 - 12
7. Tax on Unmined Taconite. 13
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10. Copper-Nickel (Cu-Ni) Production Tax . . . . . . 14 - 15
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Prepared and Submitted by:
Minnesota Department of Revenue
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TACONITE PRODUCTION TAX

Historically, taconite and semi-taconite have been exempt from the ad valorem (property) tax and have been taxed under a production tax "in lieu of" ad valorem taxes. Certain limited ad valorem taxes which do apply to the taconite industry are discussed in more detail in the section covering unmined taconite taxes. Prior to the 1940's, taconite had little value since no method had been developed to profitably produce concentrate from Minnesota's huge reserves of taconite.

In 1941 the legislature imposed a production tax on taconite and semi-taconite, which was "in lieu of" the ad valorem tax. The original tax was 5 cents per ton with an escalator equal to 0.1 cent per ton for each 1 percent that the iron content of the finished product exceeded 55 percent. The original bill provided that the proceeds of this tax should be shared equally between the state, the counties, the school districts, and the cities and townships with each receiving 25 percent.

At the time of the passage of this Act, no taconite operations existed---and only one, Reserve Mining Co., appeared on the horizon. However, since the inception of the 1941 law, taconite production has increased substantially. As production increased, major changes were made in the rate of the production tax and in the distribution. In all, there were five major changes either in the amount of the tax or in its distribution.

The last major change in the production tax was made by the 1977 legislature, and this is the law which remains in effect today. The basic tax rate was increased to $1.25 per ton of merchantable iron ore concentrate produced in 1977. The basic rate described above is increased by 1.6 percent for each 1 percent that the dry iron content exceeds 62%.

For 1978 and beyond, the basic rate of $1.25 per ton will be increased or decreased by the ratio of the steel mill products index during the production year to the steel mill products index of 1977. The index used is the steel mill products index for the month of January for the year in which the concentrate is produced as published by the U. S. Department of Labor, Bureau of Labor Statistics in the monthly Producer Price Index. (See Exhibit I)

In an effort to stabilize production tax revenues, the production tax is based on a three year average of production tons or the current year production tons, whichever is greater. This provision for averaging production was, effective starting with the 1977 production year.

The industry-wide average production tax rate for 1980 for all eight active taconite producing firms was $1.73 per ton when the iron content and price index escalations were computed. However, only two companies computed their tax rate using the current year production. The remaining six companies were required to use the average of their last three years production because their current year production was less than the average. This feature of the law, if you consider the rate in terms of current year production, does alter the effective tax rate. For 1980 the range of tax for these six companies was from $1.78 to $2.69 per ton. For Example:

National Steel (1980) Actually Produced	2,896,456 tons
*Yet, National Steel's 3 year Average Was	4,453,540 tons
National Steel's 1980 Taconite Production Tax Was	$7,801,633
Effective Rate On Current Year Production Is ($7,801,633 ÷ 2,896,456 tons)	$2.69/ton

*However, this is the tonnage that would be used in calculating National Steel's tax (again refer to Exhibit I) which would make their current year rate per taxable ton a $1.75 ($7,801,633 ÷ 4,453,540 tons).

The proceeds of the taconite production tax for 1980 are distributed as follows (all figures are cents per ton):

Taconite Cities & Towns		2.5 cents
Taconite Municipal Aid Account		12.3 cents
School Districts (Total)		29.0 cents
Taconite Schools	6 cents (part of 29¢ above)	
School districts that qualify for taconite homestead credit in proportion to their levies (See note 1)	23 cents (part of 29¢)	
Counties		19.5 cents
Taconite Counties (see note 2)	15.5 cents	
Taconite County road & bridge	4.0 cents	
Taconite Property Tax Relief (see note 3)		25.75 cents
The State		1.0 cents
I.R.R.R.B.		3.0 cents
Range Association of Schools & Municipalities		0.2 cent

Note 1: Each school district receives the amount which it was entitled to receive in 1975 from the taconite occupation tax. The remainder is then distributed to the school districts in direct proportion to school district tax levies.

Note 2: If an electric power plant owned by and providing the primary source of power for a taconite plant is located in a county other than the county in which the mining and concentrating processes are conducted, one cent of the 15.5 cents per ton shall be distributed to the county in which the power plant is located. (This 1 cent is not escalated)

Note 3: If an electric power plant owned by and providing the primary source of power for a taconite plant is located in a county other than the county in which the mining and concentrating processes are conducted, .75 cent of the 25.75 cents per ton in the taconite property tax relief account shall be distributed to the county and school district in which the power plant is located with 25% going to the county and 75% to the school district. (This .75 cent is not escallated)

Note 4: These amounts will be increased in 1979 and subsequent years by the rate of growth in the steel mill products price index.

In addition to the above distribution, additional amounts will be distributed as follows:

1. In 1978 and each year thereafter, there will be distributed to each city, town, school district, and county the amount that they received in 1977 from the distribution of the gross earnings tax on taconite railroads. Amount - - $3,160,899.
2. In 1978 and each year thereafter, there will be distributed to the Iron Range Resources and Rehabilitation Board the amount it received in 1977 from the distribution of the taconite and iron ore occupation taxes. Amount $1,252,520.
3. All proceeds from the taconite production tax, which remain after the above distributions, shall be divided between the Taconite Environmental Protection Fund. The Taconite Environmental Protection Fund will receive 2/3 and the Economic Protection Fund 1/3.

The 1979 legislature extended the taconite production tax credit of 2 cents per gross ton for school district or municipal bonds through 1983.

Exhibit I

MINNESOTA REVENUE DEPARTMENT - MINERALS TAX DIVISION
1980 Taconite Production Tax - Tax Rate Determination
(Tax Rate per Taxable Ton of 1980 Calendar Year Production)

(Minnesota Statutes Section 298.24)

Taxable Tonnage = Gross tons of merchantable grade iron ore concentrate produced from the mining and quarrying of taconite and iron sulphides (as defined by M.S. 298.23) during the calendar year or the average of the gross tons of the production, as previously defined, for the current calendar year and the previous two calendar years, whichever is higher.

Base Tax Rate = $1.25 X $\frac{\text{Jan. 1980 Steel Mill Products Index}}{\text{Jan. 1977 Steel Mill Products Index}}$

Base Tax Rate = $1.25 X $\frac{293.6}{221.3}$ = $1.65838

Additional Tax = Percent of iron content in merchantable grade iron ore concentrate when dried at 212 degrees fahrenheit, minus 62% times 1.6 times base tax rate as determined above.

Example - Based on average iron content of pellets produced of 64.62% -

64.62% - 62.00% = 2.62% X 1.6 = 4.192% X $1.65838 = $.06951

Estimated Average Effective Tax Rate - $1.727899 per taxable ton

$1.65838 X 1.04192 = $1.727899

or $1.65838 + $.06951 = $1.727899

Note: The effective tax rate will differ for each producer dependent on iron content of pellets produced by that producer.

TDL:VP

SEMI-TACONITE PRODUCTION TAX

In 1959, the Minnesota legislature imposed a tax on the production of semi-taconite. Semi-taconite is defined as altered iron formation, altered taconite, ferruginous chert or ferruginous slate which has been oxidized and partially leached and in which the iron oxide is so finely disseminated that substantially all of the iron bearing particles of merchantable grade are smaller than 20 mesh and which is not merchantable as iron ore in its natural state, and which cannot be made merchantable by simple methods of beneficiation involving only crushing, screening, washing, jigging, heavy media separation, spirals, cyclones, drying or any combination thereof.

For concentrates agglomerated or sintered in Minnesota the tax was set at 5 cents per gross ton plus .1 cent per gross ton for each 1 percent that the iron content exceeds 55% when dried at 212° fahrenheit. For other concentrates the base rate was set at 10 cents per ton with the same escallation.

One company has a small semi-taconite plant on the west end of the Mesabi Range which was last operated in 1979 on a limited scale. Prior to that this plant operated only intermittently.

The proceeds of the tax shall be distributed by the state treasurer in the following proportion:

City or Town	- 22 percent
School District	- 50 percent
County	- 22 percent
State	- 6 percent

If mining or concentration are carried on in more than 1 taxing district the commissioner shall apportion equitably between the cities, towns, and school districts upon the basis of 40% of the proceeds allocated to the districts where mining occurs and 60% to the concentrating plant.

OCCUPATION TAX

Since 1921 the State of Minnesota has imposed a tax upon producers of iron ore called the occupation tax. In nature, the occupation tax resembles a corporate income tax but in application numerous restrictions on deductible expenses exist with the occupation tax. Many items of expense which are allowable under corporate income tax laws, are not allowable under the administration of the occupation tax laws.

The impetus for the generation of a special "income tax" upon the producers of iron ore was derived from the nature of the iron ore industry in Minnesota. Practically all Minnesota iron ore is produced for consumption outside of the state, traditionally in the steel mills of the Lake Erie region. In addition, a large number of the iron ore producers in Minnesota were and still are owned by the self-same steel companies that consume the iron ore. Due to this largely captive nature of the industry and out-of-state consumption, determining a Minnesota income for iron ore producers was virtually impossible.

To avoid this problem, the Minnesota legislature passed a specific tax upon ". . . every person engaged in the business of mining or producing iron ore or other ores in this state. . ." called the occupation tax. In addition, a conceptual procedure to determine a hypothetical income from the business of mining, (called the value of ore for purpose of tax) was included in the legislation.

The procedure consists of two major steps. The first step is the determination of the value of iron ore at the mouth of a Minnesota mine, the situs of Minnesota's occupation tax. The Minnesota legislature never spelled out how this should be accomplished. Because no recognized published market price exists for ore at the mouth of a Minnesota mine, administratively the value has been determined by beginning with the place where there is the first quoted market value for iron ore which is at a Lake Erie Port. This value is known as the Lake Erie Value. We must then consider what costs are incurred along the way from the mouth of a Minnesota mine to a Lake Erie Port. These costs have come to be known as "nonstatutory deductions" and include costs for beneficiation, loading, transportation, marketing, ore analysis and marine insurance. Having determined these costs they are subtracted from the Lake Erie Value to leave the value at the mouth of Minnesota mine.

The second step in the procedure of determining a hypothetical income (the value of ore for purpose of tax) is specifically spelled out by statute, calling for the subtraction from the value at the mouth of the mine certain expenses called the "statutory deductions". The statutory deductions are:

1) mining costs

2) development costs (amortized)

3) royalty costs

4) ad valorem taxes (for taconite producers a portion of the production tax)

5) depreciation on equipment and plants

6) other miscellaneous expenses

After subtraction of the statutory deductions a taxable value of ore for purpose of tax has been determined.

As can be ascertained from a review of the aforementioned allowable deductions, Minnesota's occupation tax is more restrictive than a corporate income tax. Most noticeable as non-allowable expenses are:

1) contributions

2) general administrative business expenses out of the state

3) depletion allowances and

4) carry over of losses.

The occupation tax rate has been increased and decreased over the years from its initial rate of 6% in 1921, but in general the trend has been toward increases to its present rate of 15.5% for natural ore and 15% for taconite.

Substantial credits are allowed against the occupation tax though. Foremost of the various credits is a credit for high labor cost ores. Presently, all producers benefit from the "labor credit" with most taconite producers reducing their net effective occupation tax rate all the way from 15% to 6.75%. In addition all iron ore producers are eligible for credits for investment in pollution control equipment and costs incurred for exploration and research into Minnesota ores. Natural ore producers are also allowed a credit for costs of mining exceeding the value of ore ("loss mine credit"), while small independent iron ore producers are allowed a credit for selling ore below the quoted Lake Erie value of the ore ("discount credit").

The proceeds from the occupation tax are credited to the general fund of the state treasury, with 40% to be used for the general support of elementary and secondary schools and 10% to be used for the general support of the university.

SALES AND USE TAX

The mining industry is subject to this tax as are all other industries operating in Minnesota, however, there are special provisions unique to taconite which exempt mill liners, grinding rods and balls consumed in production.

The current rate, 5%, is charged on the gross receipts of all taxable sales made at retail and/or is imposed on the storage, use or consumption in Minnesota of taxable tangible personal property.

In addition, other exemptions are granted for accessory tools, equipment and other short lived items (less than 12 months) used in producing a direct effect upon the product as well as chemicals, fuels petroleum products, lubricants, electricity, gas and steam used or consumed in agricultural or industrial production (which includes mining).

The revenue from the sales and use tax is deposited into the General Fund.

AD VALOREM TAX ON UNMINED NATURAL IRON ORE

Since 1909 Minnesota's natural iron ore reserves have been estimated and assessed by the state for ad valorem tax purposes. The actual ad valorem tax levy is set by the county, the school district, and the local township or municipality. The tax levy is collected by the county auditor.

A Minnesota Supreme Court decision in 1936 established the present worth of future profits method for valuing the iron ore reserves. This is accomplished through the use of a complex formula known as the Hoskold Formula. The formula takes into account ore prices and all the various cost factors in determining the value of the unmined ore. Uneconomic ores which cannot be valued by the Hoskold Formula are valued according to a "class rate" system. The Department maintains a schedule of minimum rates for this purpose. The schedule currently in use was adopted in 1974 and is listed as follows:

Classification	Unit Rice Ratio
Open Pit	
Merch Ore	$ .009276
Wash Ore	.004992
Heavy Media Ore	.003865
Paint Rock Ore	.002495
Underground	
Merch Ore	$ .001546
Wash Ore	.000832
Heavy Media Ore	.000644
Paint Rock Ore	.000416

The rice ratio is the ratio of the dry iron to the sum of the dry silica plus the dry alumina (see example next page).

According to the provisions of M.S. 273.1104 a public hearing to review the valuations of unmined iron ore shall be held on the first secular day following the 10th day of October. This hearing provides an opportunity for representatives of the mining company's and taxing districts to formally protest any of the ore estimates or valuation procedures which they believe to be incorrect.

EXAMPLE OF IRON ORE VALUATION
(Using Minimum Values)

Analyses: Open Pit Heavy Media Ore (100,000 Tons)

57.2% Fe, 10.60% silica, .32% alumina

$$\text{Rice Ratio} = \frac{57.2}{10.6 + .32} = 5.24$$

Assessed Rate per Ton = \$.003865* X 5.24 = \$.02025/ton

This rate is multiplied by 3 to determine the value of the unmined ore as per M.S. 273.1104. The purpose of the 3 multiplyer is to maintain the historic assessment ratios set by the legislature between iron ore and other types of property.

3 X \$.02025 = \$.06075

In the final step the value per ton obtained above is multiplyed by the number of tons in the particular reserve.

\$.06075 X 100,000 tons = \$6,075

*From unit rice ratio table previous page.

A RECORD OF IRON ORE AD VALOREM TAXES SINCE 1970 IS LISTED AS FOLLOWS:

IRON ORE AD VALOREM TAX
(in dollars)

Year Payable	County	Local	Total
1971	3,448,777	6,773,671	10,222,448
1972	3,250,105	4,391,721	7,641,826
1973	2,921,888	4,011,868	6,933,756
1974	2,692,412	3,820,836	6,513,248
1975	2,364,788	3,264,638	5,629,426
1976	1,860,429	2,599,476	4,459,905
1977	1,741,437	2,298,178	4,039,615
1978	1,838,862	2,401,434	4,240,296
1979	1,920,313	2,483,562	4,403,875
1980	2,243,224	2,107,416	4,350,640

ROYALTY TAXES

In 1923, the Minnesota legislature passed a royalty tax law providing for a 6 percent tax on any royalties received. Since that time, the gross tax rate has exactly followed the occupation tax rates. Up until 1959, no labor credits were allowed.

The law states that the royalty recipient would pay the tax through a form of withholding by the royalty payor (the mining company). But, the courts have ruled that where the lessee (the mining company) through the terms of the lease has agreed to pay all taxes and assessments, ordinary and extraordinary, general and specific, then the mining company must pay the royalty tax.

The present tax on royalties received in connection with the exploration and mining of taconite and semi-taconite is 15%. A labor credit which reduces the effective tax rate to the net affective tax rate for occupation taxes is also allowed for taconite and semi-taconite royalty taxes on land that is being actively mined. This credit also applies in cases where the minimum royalty is in fact a pre-paid royalty specified in the terms of the mining lease. In most cases due to the labor credit the net affective occupation tax rate for taconite mining is 6.75% which also then becomes the royalty rate for taconite.

The tax on the royalties received in connection with the exploration and mining of iron ore is 15.5%. A less generous labor credit applies to the mining of natural iron ore, which in most cases reduces the effective occupation tax rate to approximately 14.5% which also then becomes the royalty rate for natural ore.

The tax on royalties received in connection with the exploration and mining of copper-nickel ores is 1% plus an additional 1% of the amount of royalty paid on gold, silver, platinum and other precious metals. Royalties on all other ores are taxed at the 15.5% rate.

All royalty tax revenue is deposited in the general fund and is not earmarked for any specific distribution.

The royalty tax is not in lieu of personal income tax on royalties. Resident and non-resident recipients of royalties are subject to state income tax in the same manner as if the royalty income were from rents or other business activities in the State of Minnesota.

TACONITE AND IRON ORE ROYALTY TAX LIABILITIES FOR PRODUCTION YEARS 1970-1979

Year	Iron Ore Production (000's) of tons)	Iron Ore Royalty Tax (000's)	Taconite Production (000's) of tons)	Taconite Royalty Tax (000's)	Cu-Ni & Uranium Royalty Tax (000's)	Total Revenue (000's)
1970	21,172	$ 966	35,348	$ 787	NA	$1,753
1971	17,530	705	33,778	1,323	NA	2,028
1972	14,439	904	34,554	1,402	NA	2,306
1973	17,941	1,289	41,829	1,886	NA	3,175
1974	17,654	1,351	41,053	1,994	NA	3,345
1975	10,258	$ 998	40,809	$2,657	NA	$3,655
1976	9,494	686	40,575	2,841	2	3,529
1977	4,647	748	26,372	2,626	2	3,376
1978	5,906	894	49,545	3,280	21	4,195
1979	4,230	807	55,333	4,775	34	5,616

TAX ON UNMINED TACONITE

Inactive taconite reserve lands are subject to a local property tax up to a statutory maximum of $10.00 per acre. Active lands are considered to be covered by the taconite production tax.

TAX ON SEVERED MINERALS INTERESTS

Severed minerals interests are subject to local property taxation. The owner of the interest must register within one year of acquisition.

The interests are taxed at 25¢ per acre. An undivided interest is calculated at 25¢ per acre times the fractional interest owned. It should also be mentioned that there is a minimum $2.00 on any mineral interest regardless of the fractional interest owned.

The taxes received are divided between local taxing districts and special accounts established to promote Indian reservation business activities.

GROSS EARNINGS TAX ON TACONITE RAILROADS

Minnesota has two mining companies, Erie Mining and Reserve Mining, that operate their own taconite railroads. These ralroads are not common carriers. Each company pays 5% tax on the theoretical gross earnings derived from the operation of the railway within the state. All other Minnesota common carriers pay ad valorem tax even if they engage in the hauling of iron ores.

The revenue collected from the gross earnings tax is directed to the General Fund.

TAXES ON COPPER-NICKEL MINING

Significant exploration activity with regard to copper and nickel minerals in northern Minnesota began in the early 1950's. This activity centered primarily around the geologic formation known as the Duluth Gabbro. Although there has been no commerical production to date, several interesting mineralized areas have been discovered.

Discussion of what would be an appropriate tax policy toward copper-nickel development continues in the legislature and among several state agencies and interested private organizations. Currently, interest is centered on a deposit controlled by Amax Company near Babbitt, Minnesota. Environmental and economic feasability studies have been conducted. However, it appears that development is at least several years away.

The following taxes currently in effect will apply to copper-nickel mining:

TYPE OF TAX	DESCRIPTION
1. Production Tax	based on crude ore production
2. Occupation Tax	based on 1% of net value of ore
*3. Corporate Income Tax . .	same as other corporations
4. Royalty Tax	1% of royalty paid
5. Sales Tax.	same as other corporations
6. Property Tax	applies to smelter & to surface interests of reserve lands.

INCOME TAX

***Reminder:** Although there is a corporate income tax on copper-nickel, there is no income tax on those corporations, individuals, estates and trusts engaged in the business of mining or producing iron ore.

A somewhat more detailed explanation of the production, occupation and royalty taxes follows:

Production Tax:

The base production tax is 2.5 cents per gross ton of crude ore plus 10% for each 1/10 of 1% that the average copper-nickel content exceeds 1% when dried at 212oF. This total is then subject to an increase proportional to the monthly average wholesale price index for all commodities for the taxable year in which the concentrate is produced compared with the 1967 index. It should be emphasized that the production tax on copper-nickel ore applies per short ton (2000 lbs) of crude ore, while the taconite production tax applies per long ton (2240 lbs) of pellets. The copper-nickel tax would be applied against a much larger base than taconite because of this difference. Revenue from this tax is to be distributed in the same manner as specified for the taconite production tax in the laws of 1965.

Occupation Tax:

The current rate of occupation tax is 1% of the value of the ore. This value is obtained in a similar manner to values used for taconite occupation tax. Two special credits are allowable. One is for converting the copper-nickel ore into a refined or semi-refined metal within the State of Minnesota.

This credit is in the amount of 2/3 of 1%. The second credit, which is less significant, is for research, experimentation, and exploration. The total occupation tax is allowable as a credit against the corporate income tax. Thus there is a definite "overlap" of occupation tax and corporate income tax.

The proceeds of the occupation tax are to be distributed 50% to the general fund, 40% for the support of elementary and secondary schools, and 10% for the general support of the University.

Royalty Tax:

The present royalty tax is 1% of the royalties paid on copper-nickel leases plus an additional 1% of the amount paid on gold, silver, platinum and other precious metals. A summary of taxes paid on copper-nickel and other mineral lease royalties is included in the section on Royalty Taxes.

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ATTACHMENT II

SUMMARY OF ISSUES
REGARDING COPPER-NICKEL
TAX POLICY

Prepared by: Interagency Working Group (Natural Resources, Revenue and State Planning)
November 10, 1980

Submitted by: Minnesota Department of Revenue
Minerals Tax Division
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AN EQUAL OPPORTUNITY EMPLOYER

INTRODUCTION

The major copper-nickel resources in northeast Minnesota could bring large economic benefits to the state and region starting in the next decade. The potential benefits must be balanced against both economic and environmental costs, and the implications of depletion of an exhaustible resource. The Regional Copper-Nickel Study, which was prepared for the Environmental Quality Board, was a comprehensive technical examination of the social, environmental and economic impacts associated with potential development of copper-nickel resources in northeast Minnesota. The study did not make recommendations for or against development; rather, the report's findings provide a necessary informational base for important policy decisions concerning copper-nickel development.

One important element in mining development over which the state has discretion is tax policy. The State Planning Agency, at the request of the Governor, convened an interagency working group in September, 1980, to provide suggestions to the Governor concerning copper-nickel tax policy. The working group included representation from the Department of Revenue, the Department of Natural Resources and the State Planning Agency.

Many factors influencing copper-nickel development are outside the direct control of the state. According to the Regional Copper-Nickel Study, the single most important influence on potential profitability is the world market price of copper and nickel. Yet, especially when the world market price for copper and nickel results in narrow profit margins, tax policy can potentially influence the timing, location and amount of copper-nickel mining.

An important factor in consideration of copper-nickel tax policy is the potential costs, both short and long-run, of development and mining. The employment and economic impact, together with anticipated tax revenues, will largely determine if development is worth the costs for the region and the state.

Findings of the Regional Copper-Nickel Study concerning social and economic impacts (including taxes) included the following:

*Mineral taxes have considerably less influence on profitability than market price or ore quality.

*Copper-nickel development could generate considerable revenues for the State of Minnesota and its local governments, depending on the type and size of mine/mill operation and the tax rate.

SUMMARY OF ISSUES

The inter-agency working group identified several aspects of copper-nickel tax policy which should be seriously considered in development of tax policy.

1) It appears desirable to levy both a production tax (on tonnage) and an occupation tax (on the net value of ore after mining and benefication) on copper-nickel mining.

   A production tax, which in Minnesota is levied in lieu of a property tax, is applied to the amount of ore mined, while an occupation tax is based on the net value (value minus operating costs, etc.) of ore. A production tax creates a tax obligation regardless of profitability or efficiency, while the occupation tax obligation is related indirectly to profitability.

2) Consideration should be given to exempting copper-nickel mining operations from the corporate income tax.

   Under current laws the corporate income tax applies to copper-nickel, but not to taconite mine/mill operations. The occupation tax is levied in lieu of the income tax on taconite operations. The two taxes allow substantially similar deductions from the tax base. Because only a small portion of a corporation's income would likely be assignable to Minnesota, and because the occupation tax is allowed as a credit against the corporate income tax, the corporate income tax would probably generate very little income for Minnesota.

3) A local ad valorem property tax should be levied on a smelter, except when location of the smelter results in substantial costs to local governments which do not share in the additional property tax base associated with the smelter. In such cases, some other type of tax should be levied by the state in lieu of a local property tax, and the proceeds returned to local governments in the mining area.

   Addition of a smelter to the local property tax base could create gross tax base disparities between localities and result in an imbalance between local government costs and revenues. if a production tax is levied, revenues should be distributed back to local governments in the area of the smelter according to an equitable formula.

4) The state should study the need and feasibility of a statewide economic protection fund financed from mineral tax revenues.

   The entire state shares an interest in the costs associated with extractive industries development and in the consequences of the exhaustion of mineral deposits. The state's ability to respond to problems of economic dislocation and to plan for an ever-changing economy could be enhanced by creation of such a fund. The fund could be used for loans or grants to cover front-end costs to the state or communities for development of new industries, for research, and for monitoring of mineral reserves and industry trends.

5) The formula for distributing copper-nickel production taxes should be evaluated to determine if it adequately meets the needs of mining area communities.

The 1965 taconite law established the production tax distribution formulas for both taconite and copper-nickel. The law for distributing taconite production tax revenues has since been changed. It is not known if the taconite distribution formula is appropriate for copper-nickel. The taconite formula is very complex -- it may not be desirable to create a similarly complex, but different formula for copper-nickel. However, the state should consider identifying a set of common principles that can guide production tax policy for all minerals.

6) Copper-Nickel policy should reflect the different needs of both industry and government during the start-up, operating, and ending stages of copper-nickel development and mining. The state should maintain flexibility in its mineral tax system to respond to changing conditions in the mining industry and in the state's revenue needs, while providing adequate guarantees of a fair and reasonably stable tax environment.

Obviously, neither the Governor nor Legislature can guarantee the details of tax laws for the duration of copper-nickel mining in Minnesota. Changes, as have occurred in taconite tax laws, will not doubt occur. Yet, if tax laws are designed now to take into account the needs and conditions associated with known stages of development and mining, the need for radical adjustments in the future should be greatly diminished.

When the location and characteristics of a mine/mill or smelter development are known, the type of analytical methods used by the Regional Copper-Nickel Study can be used to estimate specific costs and benefits to the State and localities.

Although this report deals directly with only copper-nickel mining, the working group believes that many of the issues discussed apply to mineral taxation generally. Although tax and local aid policies must be tailored to meet the unique characteristics of each type of mineral industry, the working group believes that a common set of principles should guide present and future mineral taxation policy, regardless of the type of mineral or where in the State development occurs.

Although tax legislation is not necessary, and perhaps not desirable in 1981* it is desirable for the State to establish a time-table for developing copper-nickel tax legislation. It is in the interests of both the mining companies and the affected communities to know what type of tax policy to expect.

However, mineral taxation is a highly complex and contentious issue that should not be left for the eleventh hour. Legislation is probably desirable in 1982 or 1983.* This information, and other information concerning ore grade, recovery rates and processing technology, will be influential in decisions about full-scale development. The attached summary of issues suggests some areas which the interagency working group believes deserve special consideration. Preparation of actual tax legislation will require much more intensive effort. This report only highlights areas of concern and suggests possible approaches.

*THESE COMMENTS WERE WRITTEN NOVEMBER 10, 1980. AT THIS TIME (AUGUST, 1981) IT IS FELT THAT LEGISLATION IS PROBABLY NOT DESIRABLE UNTIL 1984 OR EVEN LATER.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 80-581

Commonwealth Edison Company et al., Appellants,
v.
State of Montana et al.

On Appeal from the Supreme Court of Montana.

[July 2, 1981]

JUSTICE MARSHALL delivered the opinion of the Court.

Montana, like many other States, imposes a severance tax on mineral production in the State. In this appeal, we consider whether the tax Montana levies on each ton of coal mined in the State, Mont. Code § 15-35-101 *et seq.* (1979), violates the Commerce and Supremacy Clauses of the United States Constitution.

I

Buried beneath Montana are large deposits of low sulphur coal, most of it on federal land. Since 1921, Montana has imposed a severance tax on the output of Montana coal mines, including coal mined on federal land. After commissioning a study of coal production taxes in 1974, see House Resolution Nos. 45 and 63, Senate Resolution No. 83, Laws of Montana, 1619-1620, 1653-1654, 1683-1684 (March 14 & 16, 1974); Montana Legislative Council, Fossil Fuel Taxation (1974), in 1975, the Montana Legislature enacted the tax schedule at issue in this case. Mont. Code § 15-35-103 (1979). The tax is levied at varying rates depending on the value, energy content, and method of extraction of the coal, and may equal at a maximum, 30% of the "contract sales price." [1] Under the terms of a 1976 amendment to the Montana Constitution, after Dec. 31, 1979, at least 50% of the revenues generated by the tax must be paid into a permanent trust fund, the principal of which may be appropriated only by a vote of three-fourths of the members of each house of the legislature. Montana Const. Art. IX, § 5.

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[1] Under Mont. Code § 15-35-103 (1979), the value of the coal is deter-

Appellants, 4 Montana coal producers and 11 of their out-of-state utility company customers, filed these suits in Montana state court in 1978. They sought refunds of over $5.4 million in severance taxes paid under protest, a declaration that the tax is invalid under the Supremacy and Commerce Clauses, and an injunction against further collection of the tax. Without receiving any evidence, the court upheld the tax and dismissed the complaints.

On appeal, the Montana Supreme Court affirmed the judgment of the trial court. — Mont. —, 615 P. 2d 847 (1980). The supreme court held that the tax is not subject to scrutiny under the Commerce Clause[2] because it is imposed on the severance of coal, which the court characterized as an intrastate activity preceding entry of the coal into interstate commerce. In this regard, the Montana court relied on this Court's decisions in *Heisler* v. *Thomas Colliery Co.*, 260 U. S. 245 (1922), *Oliver Iron Mining Co.* v. *Lord*, 262 U. S. 172 (1923), and *Hope Natural Gas Co.* v. *Hall*, 274 U. S. 284 (1927), which employed similar reasoning in upholding state severance taxes against Commerce Clause challenges. As an alternative basis for its resolution of the Commerce Clause issue, the Montana court held, as a matter of law, that the

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mined by the "contract sales price" which is defined as "the price of coal extracted and prepared for shipment f. o. b. mine, excluding the amount charged by the seller to pay taxes paid on production . . . ." § 15-35-102 (1) (1979). Taxes paid on production are defined in § 15-35-102 (6) (1979). Because production taxes are excluded from the computation of the value of the coal, the effective rate of the tax is lower than the statutory rate.

[2] "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . ." U. S. Const. Art. I, § 8, cl. 3.

tax survives scrutiny under the four-part test articulated by this Court in *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274 (1977). The Montana court also rejected appellants' Supremacy Clause[3] challenge, concluding that appellants had failed to show that the Montana tax conflicts with any federal statute.

We noted probable jurisdiction. — U. S. — (1980), to consider the important issues raised. We now affirm.

II

A

As an initial matter, appellants assert that the Montana Supreme Court erred in concluding that the Montana tax is not subject to the strictures of the Commerce Clause. In appellants' view, *Heisler*'s "mechanical" approach, which looks to whether a state tax is levied on goods prior to their entry into interstate commerce, no longer accurately reflects the law. Appellants contend that the correct analysis focuses on whether the challenged tax substantially affects interstate commerce, in which case it must be scrutinized under the *Complete Auto Transit* test.

We agree that *Heisler*'s reasoning has been undermined by more recent cases. The *Heisler* analysis evolved at a time when the Commerce Clause was thought to prohibit the States from imposing any direct taxes on interstate commerce. See, *e. g.*, *Helson & Randolph* v. *Kentucky*, 279 U. S. 245, 250–252 (1929); *Ozark Pipe Line Corp.* v. *Monier*, 266 U. S. 555, 562 (1925). Consequently, the distinction between intrastate activities and interstate commerce was crucial to protecting the States' taxing power.[4]

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[3] The "Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land . . . ." U. S. Const. Art. VI, cl. 2.

[4] The *Heisler* Court explained that any other approach would "nationalize all industries, it would nationalize and withdraw from state jurisdiction and deliver to federal commercial control the fruits of Califor-

The Court has, however, long since rejected any suggestion that a state tax or regulation affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a "local" or intrastate activity. See *Hunt* v. *Washington Apple Advertising Comm'n*, 432 U. S. 333, 350 (1977); *Pike* v. *Bruce Church, Inc.*, 397 U. S. 137, 141–142 (1970); *Nippert* v. *City of Richmond*, 327 U. S. 416, 423–424 (1946). Correspondingly, the Court has rejected the notion that state taxes levied on interstate commerce are *per se* invalid. See, *e. g.*, *Washington Revenue Dept.* v. *Assocition of Wash. Stevedoring Cos.*, 435 U. S. 734 (1978); *Complete Auto Transit, Inc.* v. *Brady*, *supra*. In reviewing Commerce Clause challenges to state taxes, our goal has instead been to "establish a consistent and rational method of inquiry" focusing on "the practical effect of a challenged tax." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U. S. 425, 443 (1980). See *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267, 276–281 (1978); *Washington Revenue Dept.* v. *Association of Wash. Stevedoring Cos.*, *supra*, at 743–751; *Complete Auto Transit, Inc.* v. *Brady*, *supra*, at 227–279. We conclude that the same "practical" analysis should apply in reviewing Commerce Clause challenges to state severance taxes.

In the first place, there is no real distinction—in terms of economic effects—between severance taxes and other types of state taxes that have been subjected to Commerce Clause

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nia and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet 'on the hoof,' wool yet unshorn, and coal yet unmined, because they are in varying percentages destined for and surely to be exported to States other than those of their production." *Heisler* v. *Thomas Colliery Co.*, 260 U. S. 245, 259–260 (1922).

Of course, the "fruits of California" and the "wheat of the West" have long since been held to be within the reach of the Commerce Clause. *Pike* v. *Bruce Church, Inc.*, 397 U. S. 137 (1970); *Wickard* v. *Filburn*, 317 U. S. 111 (1942).

scrutiny.[5] See, *e. g., Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U. S. 157 (1954); *Joseph* v. *Carter & Weekes Stevedoring Co.,* 330 U. S. 422 (1947). *Puget Sound Stevedoring Co.* v. *State Tax Comm'n,* 302 U. S. 90 (1937), both overruled in *Washington Revenue Dept.* v. *Association of Wash. Stevedoring Cos., supra.*[6] State taxes levied on a "local" activity preceding entry of the goods into interstate commerce may substantially affect interstate commerce, and this effect is the proper focus of Commerce Clause inquiry. See *Mobil Oil Corp.* v. *Commissioner of Taxes, supra,* 445 U. S., at 443. Second, this Court has acknowledged that "a State has a significant interest in exacting from interstate commerce its fair share of the cost of state government." *Washington Revenue Dept.* v. *Association of Wash. Stevedoring Cos., supra,* at 748. As the Court has stated, "'[e]ven interstate business must pay its way.'" *Western Live Stock Bureau* v. *Bureau of Revenue,* 303 U. S. 250, 254 (1938), quoting *Postal Telegraph-Cable Co.* v. *Richmond,* 249 U. S. 252, 259 (1919). Consequently, the *Heisler* Court's concern that a loss of state taxing authority would be an inevitable result of subjecting taxes on "local" activities to Commerce Clause scrutiny is no longer tenable.

We therefore hold that a state severance tax is not immunized from Commerce Clause scrutiny by a claim that the tax is imposed on goods prior to their entry into the stream of interstate commerce. Any contrary statements in *Heisler* and its progeny are disapproved.[7] We agree with appellants that the Montana tax must be evaluated under *Complete Auto Transit*'s four-part test. Under that test, a state tax does not offend the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the State." 430 U. S., at 279.

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[5] The *Heisler* approach has been criticized as unresponsive to economic reality. See Hellerstein, Constitutional Constraints on State and Local Taxation of Energy Resources, 31 Nat'l Tax. J. 245, 249 (1979); Brown, The Open Economy: Justice Frankfurter and the Position of the Judiciary, 67 Yale L. J. 219, 232–233 (1957); Developments in the Law: Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev. 953, 970–971 (1962) (Developments).

[6] The *Heisler* approach has forced the Court to draw distinctions that can only be described as opaque. Compare, for example, *East Ohio Gas Co.* v. *Tax Comm'n,* 283 U. S. 465 (1931) (movement of gas into local supply lines at reduced pressure constitutes local business) with *State Tax Comm'n* v. *Interstate Natural Gas Co., Inc.,* 284 U. S. 41 (1931) (movement of gas into local supply lines constitutes part of interstate business).

B

Appellants do not dispute that the Montana tax satisfies the first two prongs of *Complete Auto Transit* test. As the Montana Supreme Court noted, "there can be no argument here that a substantial, in fact, the only nexus of the severance of coal is established in Montana." — Mont., at —, 615 P. 2d, at 855. Nor is there any question here regarding apportionment or potential multiple taxation, for as the state court observed, "the severance can occur in no other state" and "no other state can tax the severance." *Ibid.* Appellants do contend, however, that the Montana tax is invalid under the third and fourth prongs of the *Complete Auto Transit* test.

Appellants assert that the Montana tax "discriminate[s] against interstate commerce" because 90% of Montana coal is shipped to other States under contracts that shift the tax burden primarily to non-Montana utility companies and thus to citizens of other States. But the Montana tax is computed at the same rate regardless of the final destination of the coal, and there is no suggestion here that the tax is administered in a manner that departs from this even-handed formula. We are not, therefore, confronted here with the type of differential tax treatment of interstate and intrastate commerce that the Court has found in other "discrimination" cases. See, *e. g., Maryland* v. *Louisiana*, — U. S. — (1981); *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U. S. 318 (1977); cf. *Lewis* v. *BT Investment Managers, Inc.*, 447 U. S. 27 (1980); *Philadelphia* v. *New Jersey*, 437 U. S. 617 (1978).

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[7] This is not to suggest, however, that *Heisler* and its progeny were wrongly decided.

Instead, the gravamen of appellants' claim is that a state tax must be considered discriminatory for purposes of the Commerce Clause if the tax burden is borne primarily by out-of-state consumers. Appellants do not suggest that this assertion is based on any of this Court's prior discriminatory tax cases. In fact, a similar claim was considered and rejected in *Heisler*. There, it was argued that Pennsylvania had a virtual monopoly of anthracite coal and that, because 80% of the coal was shipped out of State, the tax discriminated against and impermissibly burdened interstate commerce. 260 U. S. 251–253. The Court, however, dismissed these factors as "adventitious considerations." 260 U. S., at 259. We share the *Heisler* Court's misgivings about judging the validity of a state tax by assessing the State's "monopoly" position or its "exportation" of the tax burden out of State.

The premise of our discrimination cases is that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod* v. *J. E. Dilworth Co.*, 322 U. S. 327, 330 (1944). See *Hunt* v. *Washington State Apple Advertising Comm'n*, 432 U. S. 333, 350 (1977); *Boston Stock Exchange* v. *State Tax Comm'n*, *supra*, at 328. Under such a regime, the borders between the States are essentially irrelevant. As the Court stated in *West* v. *Kansas Natural Gas Co.*, 221 U. S. 229, 255 (1911), "in matters of foreign and interstate commerce there are no state lines." See *Boston Stock Exchange* v. *State Tax Comm'n*, *supra, at* 331–332. Consequently, to accept appellants' theory and invalidate the Montana tax solely because most of Montana's coal is shipped across the very state borders that ordinarily are to be considered irrelevant would require a significant and, in our view, unwarranted departure from the rationale of our prior discrimination cases.

Furthermore, appellants' assertion that Montana may not "exploit" its "monopoly" position by exporting tax burdens to other States, cannot rest on a claim that there is need to protect the out-of-state consumers of Montana coal from discriminatory tax treatment. As previously noted, there is no real discrimination in this case; the tax burden is borne according to the amount of coal consumed and not according to any distinction between in-state and out-of-state consumers. Rather, appellants assume that the Commerce Clause gives residents of one State a right of access at "reasonable" prices to resources located in another State that is richly endowed with such resources, without regard to whether and on what terms residents of the resource-rich State have access to the resources. We are not convinced that the Commerce Clause, of its own force, gives the residents of one State the right to control in this fashion the terms of resource development and depletion in a sister State. Cf. *Philadelphia* v. *New Jersey, supra,* 437 U. S., at 626.[8]

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[8] Nor do we share appellants' apparent view that the Commerce Clause injects principles of antitrust law into the relations between the States by reference to such imprecise standards as whether one State is "exploiting" its "monopoly" position with respect to a natural resource when the flow of commerce among them is not otherwise impeded. The threshold questions whether a State enjoys a "monopoly" position and whether the tax burden is shifted out-of-state, rather than borne by in-state producers and consumers, would require complex factual inquiries about such issues as elasticity of demand for the product and alternate sources of supply. Moreover, under this approach, the constitutionality of a state tax could well turn on whether the in-state producer is able, through sales contracts or otherwise, to shift the burden of the tax forward to its out-of-state customers. As the Supreme Court of Montana observed, "[i]t would be strange indeed if the legality of a tax could be made to depend on the vagaries of the terms of contracts." — Mont., at —, 615 P. 2d., at 856. It has been suggested that the "formidable evidentiary difficulties in appraising the geographical distribution of industry, with a view toward

In any event, appellants' discrimination theory ultimately collapses into their claim that the Montana tax is invalid under the fourth prong of the *Complete Auto Transit* test: that the tax is not "fairly related to the services provided by the State." 430 U. S., at 279. Because appellants concede that Montana may impose *some* severance tax on coal mined in the State,[9] the only remaining foundation for their discrimination theory is a claim that the tax burden borne by the out-of-state consumers of Montana coal is excessive. This is, of course, merely a variant of appellants' assertion that the Montana tax does not satisfy the "fairly related" prong of the *Complete Auto Transit* test, and it is to this contention that we now turn.

Appellants argue that they are entitled to an opportunity to prove that the amount collected under the Montana tax is not fairly related to the additional costs the State incurs because of coal mining.[10] Thus, appellants' objection is to

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determining a state's monopolistic position, might make the Court's inquiry futile." *Developments, supra* n. 5, at 970. See W. Hellerstein, *supra* n. 5, at 248–249.

[9] Since this Court has held that interstate commerce must bear its fair share of state tax burden, see *Western Live Stock Bureau* v. *Bureau of Revenue*, 303 U. S. 250, 254 (1938), appellants cannot argue that *no* severance tax may be imposed on coal primarily destined for interstate commerce.

[10] Appellants expect to show that the "legitimate local impact costs [of coal mining]—for schools, roads, police, fire and health protection, and environmental protection and the like—might amount to approximately 2 [cents] per ton, compared to present average revenues from the severance tax alone of over $2.00 per ton." Brief for Appellants, at 12. Appellants contend that inasmuch as 50% of the revenues generated by the Montana tax is "cached away, in effect, for unrelated and unknown purposes," it is clear that the tax is not fairly related to the services furnished by the State. Reply Brief for Appellants, at 8.

At oral argument before the Montana Supreme Court, appellants' counsel suggested that a tax of "perhaps twelve and a half to fifteen percent of the value of the coal" would be constitutional. — Mont. —, —, 651 P. 2d 847, 851 (1980).

the *rate* of the Montana tax, and even then, their only complaint is that the *amount* the State receives in taxes far exceeds the *value* of the services provided to the coal mining industry. In objecting to the tax on this ground, appellants may be assuming that the Montana tax is, in fact, intended to reimburse the State for the cost of specific services furnished to the coal mining industry. Alternatively, appellants could be arguing that a State's power to tax an activity connected to interstate commerce cannot exceed the value of the services specifically provided to the activity. Either way, the premise of appellants' argument is invalid. Furthermore, appellants have completely misunderstood the nature of the inquiry under the fourth prong of the *Complete Auto Transit* test.

The Montana Supreme Court held that the coal severance tax is "imposed for the general support of the government." — Mont., at —, 615 P. 2d, at 856, and we have no reason to question this characterization of the Montana tax as a general revenue tax.[11] Consequently, in reviewing appellant's contentions, we put to one side those cases in which the Court reviewed challenges to "user" fees or "taxes" that were designed and defended as a specific charge imposed by the State for the use of state-owned or state-provided transportation or other facilities and services. See. *e. g., Evansville-Vanderburgh Airport Authority Dist.* v. *Delta Airlines, Inc.*, 405 U. S. 707 (1972); *Clark* v. *Paul Gray, Inc.*, 306 U. S. 583 (1939); *Ingels* v. *Morf*, 300 U. S. 290 (1937).[12]

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[11] Contrary to appellants' suggestion, the fact that 50% of the proceeds of the severance tax is paid into a trust fund does not undermine the Montana court's conclusion that the tax is a general revenue tax. Nothing in the Constitution prohibits the people of Montana from choosing to allocate a portion of current tax revenues for use by future generations.

[12] As the Court has stated, "such imposition, although termed a tax, cannot be tested by standards which generally determine the validity of taxes." *Interstate Transit, Inc.* v. *Lindsey*, 283 U. S. 183, 190 (1931). Because such charges are purportedly assessed to reimburse the State for

This Court has indicated that States have considerable latitude in imposing general revenue taxes. The Court has, for example, consistently rejected claims that the Due Process Clause of the Fourteenth Amendment stands as a barrier against taxes that are "unreasonable" or "unduly burdensome." See, *e. g., Pittsburgh* v. *Alco Parking Corp.*, 417 U. S. 369 (1974); *Magnano Co.* v. *Hamilton,* 292 U. S. 40 (1934); *Alaska Fish Salting & By-Products Co.* v. *Smith,* 255 U. S. 44 (1921). Moreover, there is no requirement under the Due Process Clause that the amount of general revenue taxes collected from a particular activity must be reasonably related to the value of the services provided to the activity. Instead, our consistent rule has been:

> "Nothing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.
>
> "A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would pre-

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costs incurred in providing specific quantifiable services, we have required a showing, based on factual evidence in the record, that "the fees charged do not appear to be manifestly disproportionate to the services rendered . . . ." *Clark* v. *Paul Gray, Inc.*, 306 U. S. 583, 599 (1939). See *id.*, at 598–600; *Ingels* v. *Morf,* 300 U. S. 290, 296–297 (1937).

One commentator has suggested that these "user" charges "are not true revenue measures and . . . the considerations applicable to ordinary tax measures do not apply." P. Hartman, State Taxation of Interstate Commerce 20, n. 72 (1953). Instead, "user" fees "partak[e] . . . of the nature of a rent charged by the State, based upon its proprietary interest in its public property, [rather] than of a tax, as that term is thought of in a technical sense." *Id.*, at 122. See generally *id.*, at 122–130.

> clude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government—that it exists primarily to provide for the common good." *Carmichael* v. *Southern Coal & Coke Co.*, 301 U. S. 495, 521–522 (1937) (citations omitted).

See *St. Louis & S. W. R. Co.* v. *Nattin*, 277 U. S. 157, 159 (1928); *Thomas* v. *Gay*, 169 U. S. 264, 280 (1898).

There is no reason to suppose that this latitude afforded the States under the Due Process Clause is somehow divested by the Commerce Clause merely because the taxed activity has some connection to interstate commerce; particularly when the tax is levied on an activity conducted within the State. "The exploitation by foreign corporations [or consumers] of intrastate opportunities under the protection and encouragement of local government offers a basis for taxation as unrestricted as that for domestic corporations." *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331, 334–335 (1939); see also *Ott* v. *Mississippi Valley Barge Line Co.*, 336 U. S. 169 (1949). To accept appellants' apparent suggestion that the Commerce Clause prohibits the States from requiring an activity connected to interstate commerce to contribute to the general cost of providing governmental services, as distinct from those costs attributable to the taxed activity, would place such commerce in a privileged position. But as we recently reiterated, " '[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.' " *Colonial Pipeline Co.* v. *Traigle*, 421 U. S. 100, 108 (1975), quoting *Western Live Stock* v. *Bureau of Revenue*, 303 U. S., at 254. The "just share of state tax burden" includes sharing in the cost of providing "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.' "

Exxon Corp. v. *Wisconsin Dept. of Revenue*, 447 U. S., at 228, quoting *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S., at 445. See *Washington Revenue Dept.* v. *Association of Wash. Stevedoring Cos.*, 435 U. S., at 750–751; *id.*, at 764 (POWELL, J., concurring); *General Motors Corp.* v. *Washington*, 377 U. S. 436, 440–441 (1964).

Furthermore, there can be no question that Montana may constitutionally raise general revenue by imposing a severance tax on coal mined in the State. The entire value of the coal, before transportation, originates in the State, and mining of the coal depletes the resource base and wealth of the State, thereby diminishing a future source of taxes and economic activity.[13] Cf. *Maryland* v. *Louisiana*, — U. S., at — (slip op., at 32). In many respects, a severance tax is like a real property tax, which has never been doubted as a legitimate means of raising revenue by the situs State (quite apart from the right of that or any other State to tax income derived from use of the property). See, *e. g., Old Dominion Steamship Co.* v. *Virginia*, 198 U. S. 299 (1905); *Western Union Telegraph Co.* v. *Gottlieb*, 190 U. S. 412 (1903); *Postal Telegraph Cable Co.* v. *Adams*, 155 U. S. 688 (1895). When, as here, a general revenue tax does not discriminate against interstate commerce and is apportioned to activities occurring within the State, the State "is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *Wisconsin* v. *J. C.*

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[13] Most of the States raise revenue by levying a severance tax on mineral production. The first such tax was imposed by Michigan in 1846. See United States Department of Agriculture, State Taxation of Mineral Deposits and Production (1978). By 1979, 33 States had adopted some type of severance tax. See Bureau of Census, State Government Tax Collections in 1979, Table 3 (1980).

Penney Co., 311 U. S. 435. 444 (1940). As we explained in *General Motors Corp.* v. *Washington*, *supra*, at 440–441,

> "the validity of the tax rests upon whether the State is exacting a constitutionally fair demand for that aspect of interstate commerce to which it bears a special relation. For our purposes, the decisive issue turns on the operating incidence of the tax. In other words, the question is whether the State has exerted its power in proper proportion to appellant's activities within the State and to appellant's consequent enjoyment of the opportunities and protections which the State has afforded. . . . As was said in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, 444 (1940), '[t]he simple but controlling question is whether the state has given anything for which it can ask return.'"

The relevant inquiry under the fourth prong of the *Complete Auto Transit* test[14] is not, as appellants suggest, the *amount* of the tax or the *value* of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities.[15] Rather, the test is closely connected to the first prong of the *Complete Auto Transit* test. Under this threshold test, the interstate business must have a substantial nexus with the State before *any* tax may be levied on it. See *National Bellas Hess, Inc.* v. *Illinois Revenue Dept.*, 386 U. S. 753 (1967). Beyond that threshold requirement, the fourth prong of the *Complete Auto Transit* test imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a "just share of state tax burden." *Western Live Stock Bureau* v. *Bureau of Revenue*, 303 U. S., at 254. See *National Geographic Society* v. *California Board of Equalization*, 430 U. S. 551 (1977); *Standard Pressed Steel Co.* v. *Washington Revenue Dept.*, 419 U. S. 560 (1975). As the Court explained in *Wisconsin* v. *J. C. Penney Co., supra*, at 446 (emphasis added), "the incidence of the tax *as well as its measure* [must be] tied to the earnings which the State . . . has made possible, insofar as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes."

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[14] The fourth prong of the *Complete Auto Transit* test is derived from *General Motors*, *J. C. Penney*, and similar cases. See *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274, 279, n. 8 (1977); see also *National Geographic Society* v. *California Board of Equalization*, 430 U. S. 551, 558 (1977).

[15] Indeed, the words "amount" and "value" were not even used in *Complete Auto Transit*. See 430 U. S., at 279. Similiarly, our cases applying the *Complete Auto Transit* test have not mentioned either of these words. See *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U. S. 207, 228 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U. S. 425, 443 (1980); *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434, 444–445 (1979); *Washington Revenue Dept.* v. *Association of Wash. Stevedoring Cos.*, 435 U. S. 734, 750 (1978); *National Geographic Society* v. *California Board of Equalization*, *supra*, at 558.

Against this background, we have little difficulty concluding that the Montana tax satisfies the fourth prong of the *Complete Auto Transit* test. The "operating incidence" of the tax, see *General Motors Corp.* v. *Washington, supra*, at 440–441, is on the mining of coal within Montana. Because it is measured as a percentage of the value of the coal taken, the Montana tax is in "proper proportion" to appellants' activities within the State and, therefore, to their "consequent enjoyment of the opportunities and protections which the State has afforded" in connection to those activities. *Id.*, at 441. Compare *Nippert* v. *City of Richmond*, 327 U. S., at 427. When a tax is assessed in proportion to a taxpayer's activities or presence in a State, the taxpayer is shouldering its fair share of supporting the State's provision of "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.'" *Exxon Corp.* v.

Wisconsin Dept. of Revenue, 447 U. S., at 228, quoting *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S., at 445.

Appellants argue, however, that the fourth prong of the *Complete Auto Transit* test must be construed as requiring a factual inquiry into the relationship between the revenues generated by a tax and costs incurred on account of the taxed activity, in order provide a mechanism for judicial disapproval under the Commerce Clause of state taxes that are excessive. This assertion reveals that appellants labor under a misconception about a court's role in cases such as this.[16] The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution.[17] See *Helson & Randolph* v. *Kentucky*, 279 U. S. 245, 252 (1929); cf. *Pittsburgh* v. *Alco Parking Corp.*, 417 U. S. 369 (1974); *Magnano Co.* v. *Hamilton*, 292 U. S. 40 (1934). In essence, appellants ask this Court to prescribe a test for the validity of state taxes that would require state and federal courts, as a matter of federal constitutional law, to calculate acceptable rates or levels of taxation of activities that are conceded to be legitimate subjects of taxation. This we decline to do.

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[16] In any event, the linchpin of appellants' contention is the incorrect assumption that the amount of state taxes that may be levied on an activity connected to interstate commerce is limited by the costs incurred by the State on account of that activity. Only then does it make sense to advocate judicial examination of the relationship between taxes paid and benefits provided. But as we have previously noted, see *supra*, at 12, interstate commerce may be required to contribute to the cost of providing *all* governmental services, including those services from which it arguably receives no direct "benefit." In such circumstances, absent an equal protection challenge (which appellants do not raise), and unless a court is to second-guess legislative decisions about the amount or disposition of tax revenues, it is difficult to see how the court is to go about comparing costs and benefits in order to decide whether the tax burden on an activity connected to interstate commerce is excessive.

[17] Of course, a taxing statute may be judicially disapproved if it is "so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property." *Magnano Co.* v. *Hamilton*, 292 U. S. 40, 44 (1934).

In the first place, it is doubtful whether any legal test could adequately reflect the numerous and competing economic, geographic, demographic, social, and political considerations that must inform a decision about an acceptable rate or level of state taxation, and yet be reasonably capable of application in a wide variety of individual cases. But even apart from the difficulty of the judicial undertaking, the nature of the factfinding and judgment that would be required of the courts merely reinforces the conclusion that questions about the appropriate level of state taxes must be resolved through the political process. Under our federal system, the determination is to be made by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests.[18] Cf. *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U. S., at 448–449; *Moorman Manufacturing Co.* v. *Bair,* 437 U. S., at 280.

Furthermore, the reference in the cases to police and fire protection and other advantages of civilized society is not, as appellants suggest, a disingenuous incantation designed to avoid a more searching inquiry into the relationship between the *value* of the benefits conferred on the taxpayer and the *amount* of taxes it pays. Rather, when the measure of a tax is reasonably related to the taxpayer's activities or presence in the State—from which it derives some benefit such as the substantial privilege of mining coal—the taxpayer will realize, in proper proportion to the taxes it pays, "[t]he only benefit to which it is constitutionally entitled . . . [:] that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes." *Carmichael* v. *Southern Coal & Coke Co.*, 301 U. S., at 522. Correspondingly, when the measure of a tax bears no relationship to the taxpayers presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce. See *Nippert* v. *City of Richmond*, 327 U. S., at 427; cf. *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U. S. 157 (1954). We are satisfied that the Montana tax, assessed under a formula that relates the tax liability to the value of appellant coal producers' activities within the State, comports with the requirements of the *Complete Auto Transit* test. We therefore turn to appellants' contention that the tax is invalid under the Supremacy Clause.

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[18] The controversy over the Montana tax has not escaped the attention of the Congress. Several bills were introduced during the 96th Congress to limit the rate of state severance taxes. See S. 2695, H. R. 6625, H. R. 6654 and H. R. 7163. Similar bills have been introduced in the 97th Congress. See S. 178, H. R. 1313.

III

A

Appellants contend that the Montana tax, as applied to mining of federally owned coal, is invalid under the Supremacy Clause because it "substantially frustrates" the purposes of the Mineral Lands Leasing Act of 1920, ch. 85, 41 Stat. 437, 30 U. S. C. § 181 *et seq.* (1920 Act), as amended by the Federal Coal Leasing Amendments Act of 1975, Pub. L. 94-377, 90 Stat. 1083 (1975 Amendments). Appellants argue that under the 1920 Act, the "economic rents" attributable to the mining of coal on federal land—*i. e.*, the difference between the cost of production (including a reasonable profit) and the market price of the coal—are to be captured by the Federal Government in the form of royalty payments from federal lessees. The payments thus received are then to be divided between the States and the Federal Government according to a formula prescribed by the Act.[19] In appellants' view, the Montana tax seriously undercuts and disrupts the 1920 Act's division of revenues between the federal and state governments by appropriating directly to Montana a major portion of the "economic rents." Appellants contend the Montana tax will alter the statutory scheme by causing potential coal producers to reduce the amount they are willing to bid in royalties on federal leases.

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[19] As originally enacted in 1920, § 35 of the Mineral Lands Leasing Act, ch. 85, 41 Stat. 450, 30 U. S. C. § 191 (1970 ed.), provided that

As an initial matter, we note that this argument rests on a factual premise—that the principal effect of the tax is to shift a major portion of the relatively fixed "economic rents" attributable to the extraction of federally owned coal from the Federal Treasury to the State of Montana—that appears to be inconsistent with the premise of appellants' Commerce Clause claims. In pressing their Commerce Clause arguments, appellants assert that Montana tax increases the cost of Montana coal, thereby *increasing* the total amount of "economic rents," and that the burden of the tax is borne by out-of-state consumers, not the Federal Treasury.[20] But

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all receipts from the leasing of public lands under the Act were to be paid into the United States Treasury and then divided as follows: 37.5% to the State in which the leased lands are located; 52.5% to the reclamation fund created by the Reclamation Act of 1902, ch. 1093, § 1, 32 Stat. 388, 43 U. S. C. § 391; and the remaining 10% to be deposited in the Treasury under "miscellaneous receipts."

Section 35 was amended by § 9 (a) of the Federal Coal Leasing Amendments Act of 1975, Pub. L. 94-377, 90 Stat. 1089, to provide for a new statutory formula which is currently in effect. Under this formula, the State in which the mining occurs receives 50% of the revenues, the reclamation fund receives 40%, and the United States Treasury the remaining 10%. 30 U. S. C. § 191.

[20] Indeed, appellants alleged in their complaints that the contracts between appellant coal producers and appellant utility companies *require* the utility companies to reimburse the coal producers for their severance tax payments, and that the ultimate incidence of the tax primarily falls on the utilities' out-of-state customers. Comp. ¶¶ 17, 18. Jurisdictional Statement Appendix (J. S. App.) 53a-54a. Presumably, with regard to these contracts, the Federal Government's receipts will be unaffected by the Montana tax.

even assuming that the Montana tax may reduce royalty payments to the Federal Government under leases executed in Montana, this fact alone hardly demonstrates that the tax is inconsistent with the 1920 Act. Indeed, appellants' argument is substantially undermined by the fact that in § 32 of the 1920 Act, 30 U. S. C. § 189, Congress expressly authorized the States to impose severance taxes on federal lessees without imposing any limits on the amount of such taxes. Section 32 provides in pertinent part:

> "Nothing in this chapter shall be construed or held to affect the rights of the States or other local authority to exercise any rights which they may have, including the right to levy and collect taxes upon improvements, outputs of mines, or other rights, property, or assets of any lessee of the United States."

This Court had occassion to construe § 32 soon after it was enacted. The Court explained that

> "Congress . . . meant by the proviso to say in effect that, although the act deals with the letting of public lands and the relations of the [federal] government to the lessees thereof, nothing in it shall be so construed as to affect the right of the states, in respect of such private persons and corporations, to *levy and collect taxes as though the government were not concerned*. . . .
>
> * * * * *
>
> "We think the proviso plainly discloses the intention of Congress that *persons and corporations contracting with the United States under the act, should not, for that reason, be exempt from any form of state taxation otherwise lawful.*" *Mid-Northern Oil Co.* v. *Walker*, 268 U. S. 45, 48–50 (1925) (emphasis added).

It necessarily follows that if the Montana tax is "otherwise lawful," the 1920 Act does not forbid it.

Appellants contend that the Montana tax is not "otherwise lawful" because it conflicts with the very purpose of the 1920 Act. We do not agree. There is nothing in language or legislative history of either the 1920 Act or the 1975 Amendments to support appellants' assertion that Congress intended to maximize and capture *all* "economic rents" from the mining of federal coal, and then to distribute the proceeds in accordance with the statutory formula. The House Report on the 1975 Amendments, for example, speaks only in terms of a congressional intent to secure a "fair return to the public." H. R. Rep. No. 94-681, at 17-18 (1975). Moreover, appellants' argument proves too much. By definition, any state taxation of federal lessees reduces the "economic rents" accruing to the Federal Government, and appellants' argument would preclude any such taxes despite the explicit grant of taxing authority to the States by § 32. Finally, appellants' contention necessarily depends on inferences to be drawn from §§ 7 and 35 of the 1920 Act, 30 U. S. C. §§ 207 and 191, which, as amended, prescribe the statutory formula for the division of the payments received by the Federal Government. See Comp. ¶¶ 38-41, J. S. App. 57a-58a. Yet § 32 of the 1920 Act states that "[n]othing in this chapter"—which includes §§ 7 and 35—"shall be construed or held to affect the rights of the States . . . to levy and collect taxes upon . . . output of mines . . . of any lessee of the United States." 30 U. S. C. § 189. And if, as the Court has held, the States may "levy and collect taxes as though the [federal] government were not concerned," *Mid-Northern Oil Co.* v. *Walker*, *supra*, at 49, the manner in which the Federal Government collects receipts from its lessees and then shares them with the States has no bearing on the validity of a state tax. We therefore reject appellants' contention that the Montana tax must be invalidated as inconsistent with the Mineral Lands Leasing Act.

B

The final issue we must consider is appellants' assertion that the Montana tax is unconstitutional because it substantially frustrates national energy policies. reflected in several federal statutes, encouraging the production and use of coal, particularly low sulphur coal such as is found in Montana. Appellants insist that they are entitled to a hearing to explore the contours of these national policies and to adduce evidence supporting their claim that the Montana tax substantially frustrates and impairs the policies.

We cannot quarrel with appellants' recitation of federal statutes encouraging the use of coal. Appellants correctly note that § 2 (6) of the Energy Policy and Conservation Act of 1975, 42 U. S. C. § 6201 (6). declares that one of the Act's purposes is "to reduce the demand for petroleum products and natural gas through programs designed to provide greater availability and use of this Nation's abundant coal resources." And § 102 (b)(3) of the Powerplant and Industrial Fuel Use Act of 1978 (PIFUA). 42 U. S. C. § 8301 (b)(3) (1976 ed., Supp. III), recites a similar objective "to encourage and foster the greater use coal and other alternative fuels, in lieu of natural gas and petroleum, as a primary energy source." We do not. however, accept appellants' implicit suggestion that these general statements demonstrate a congressional intent to pre-empt all state legislation that may have an adverse impact on the use of coal. In *Exxon Corp.* v. *Governor of Maryland,* 437 U. S. 117 (1978). we rejected a pre-emption argument similar to the one appellants urge here. There, it was argued that the "basic national policy favoring free competition" reflected in the Sherman Act pre-empted a state law regulating retail distribution of gasoline. *Id.,* at 133. The Court acknowledged the conflict between the state law and this national policy, but rejected the suggestion that the "broad implications" of the Sherman Act should be construed as a congressional decision to pre-empt the state law. *Id.,* at 133–134. Cf. *New Motor Vehicle Bd. of California* v. *Orrin W. Fox Co.,* 439 U. S. 96, 110–111 (1978). As we have frequently indicated. "[p]re-emption of state law by federal statute or regulation is not favored 'in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained.'" *Chicago North Western & Transp. Co.* v. *Kalo Brick & Tile*, — U. S. —, — (1981), quoting *Florida Lime & Avocado Growers, Inc.*, v. *Paul*, 373 U. S. 132, 142 (1963). See *Alessi* v. *Raybestos-Manhattan, Inc.*, — U. S. —, — (1981); *Jones* v. *Rath Packing Co.*, 430 U. S. 519, 525-526 (1977); *Perez* v. *Campbell*, 402 U. S. 637, 649 (1971). In cases such as this, it is necessary to look beyond general expressions of "national policy" to specific federal statutes with which the state law is claimed to conflict.[21] The only specific statutory provisions favoring the use of coal cited by appellants are those in PIFUA.

PIFUA prohibits new electric power plants or new major fuel-burning installations from using natural gas or petroleum as a primary energy source, and prohibits existing facilities from using natural gas as a primary energy source after 1989. 42 U. S. C. §§ 8311 (1), 8312 (a) (1976 ed., Supp. III). Appellants contend that "the manifest purpose of this Act to favor the use of coal is clear." Brief for Appellants, at 37. As the statute itself makes clear, however, Congress did not intend PIFUA to pre-empt state severance taxes on coal. Section 601 (a)(1) of PIFUA, 42 U. S. C. § 8401 (a)(1), provides for federal financial assistance to areas of a State adversely affected by increased coal or uranium mining, based upon findings by the Governor of the State that the state or local government lacks the financial resources to meet increased demand for housing or public services and facilities in such areas. Section 601 (a)(2), 42 U. S. C. (1976 ed., Supp. III) § 8401 (a)(2), then provides that

"increased revenues, *including severance tax revenues,*

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[21] Thus, in *Exxon*, after rejecting the "national policy" pre-emption argument, the Court went on to consider more focused allegations concerning alleged conflicts between the state law and specific provisions of the Robinson-Patman Act. *Exxon Corp.* v. *Governor of Maryland*, 437 U. S. 117, 129-133 (1978).

> royalties, and similar fees to the State and local governments which are associated with the increase in coal or uranium development activities . . . shall be taken into account in determining if a State or local government lacks financial resources."

This section clearly contemplates the continued existence, not the pre-emption, of state severance taxes on coal and other minerals.

Furthermore, the legislative history of § 601 (a)(2) reveals that Congress enacted this provision with Montana's tax specifically in mind. The Senate version of the PIFUA bill provided for impact aid, but the House bill did not. See H. R. Conf. Rep. No. 95–1749, at 93 (1978). The Senate's proposal for impact aid was opposed by the House conferees, who took the position that the States would be able to satisfy the demand for additional facilities and services caused by increased coal production through imposition of severance taxes and, in Western States, through royalties received under the Mineral Lands Leasing Act. See Transcript of the Joint Conference on Energy, at 1822, 1824, 1832, 1834–1837, 1839 (Nov. 9, 1977) (Tr.), reprinted in 2 United States Department of Energy, Legislative History of the Powerplant and Industrial Fuel Use Act, 777, 779, 787, 789–792, 794 (1978) (Legislative History). In explaining the objections of the House conferees, Rep. Eckhardt pointed out:

> "[T]he western states may collect severance taxes on that coal.
>
> "As I pointed out [see Tr. 1822, *Legislative History* at 777], Montana already collects $3 a ton on severance taxes on coal and still enjoys a 50 percent royalty return. As the price of coal goes up . . . these severance taxes in addition go up.
>
> "This is a percentage tax, not a flat tax in most instances.
>
> "If we are going to merely determine on the basis of

> impact on a particular community in a state how much money is going to go to that community, without taking into account how much that community is enriched, I think we are going to have people who are so angry at us in Congress . . . ." Tr. 1835, Legislative History, at 790.

Section 601 (a)(2) was obviously included in PIFUA as a response to these concerns, for it provides that severance taxes and royalties are to be "taken into account" in determining eligibility for impact aid. The legislative history of § 601 (a)(2) thus confirms what seems evident from the face of the statute—that Montana's severance tax is not pre-empted by PIFUA. Since PIFUA is the only federal statute that even comes close to providing a specific basis for appellants' claims that the Montana statute "substantially frustrates" federal energy policies, this aspect of appellants' Supremacy Clause argument must also fail.[22]

IV

In sum, we conclude that appellants have failed to demonstrate either that the Montana tax suffers from any of the constitutional defects alleged in their complaints, or that a trial is necessary to resolve the issue of the constitutionality of the tax. Consequently, the judgment of the Supreme Court of Montana is affirmed.

So ordered.

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[22] Appellants' assertion that the Montana tax is pre-empted by the Clean Air Act, 42 U. S. C. § 7401 *et seq.* (1976 ed., Supp. III), merits little discussion. The Clean Air Act does not mandate the use of coal; it merely prescribes standards governing the emission of sulphur dioxide when coal is used. Any effect those standards might have on the use of high or low sulphur coal is incidental.

SUPREME COURT OF THE UNITED STATES

No. 80-581

Commonwealth Edison Company et al., Appellants, v. State of Montana et al.	On Appeal from the Supreme Court of Montana.

[July 2, 1981]

JUSTICE WHITE, concurring.

This is a very troublesome case for me, and I join the Court's opinion with considerable doubt and with the realization that Montana's levy on consumers in other States may in the long run prove to be an intolerable and unacceptable burden on commerce. Indeed, there is particular force in the argument that the tax is here and now unconstitutional. Montana collects most of its tax from coal lands owned by the Federal Government and hence by all of the people of this country, while at the same time sharing equally and directly with the Federal Government all of the royalties reserved under the leases the United States has negotiated on its land in the State of Montana. This share is intended to compensate the State for the burdens that coal mining may impose upon it. Also, as JUSTICE BLACKMUN cogently points out, *post*, at —, n. 9, another 40% of the federal revenue from mineral leases is indirectly returned to the States through a reclamation fund. In addition, there is statutory provision for federal grants to areas affected by increased coal production.

But this very fact gives me pause and counsels withholding our hand, at least for now. Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. It is also very much aware of the Nation's energy needs, of the Montana tax and of the trend in the energy-rich

States to aggrandize their position and perhaps lessen the tax burdens on their own citizens by imposing unusually high taxes on mineral extraction. Yet, Congress is so far content to let the matter rest, and we are counseled by the Executive Branch through the Solicitor General not to overturn the Montana tax as inconsistent with either the Commerce Clause or federal statutory policy in the field of energy or otherwise. The constitutional authority and the machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress, and surely Montana and other similarly situated States do not have the political power to impose their will on the rest of the country. As I presently see it, therefore, the better part of both wisdom and valor is to respect the judgment of the other branches of the Government. I join the opinion and the judgment of the Court.

SUPREME COURT OF THE UNITED STATES

No. 80-581

Commonwealth Edison Company et al., Appellants, *v.* State of Montana et al.	On Appeal from the Supreme Court of Montana.

[July 2, 1981]

JUSTICE BLACKMUN, with whom JUSTICE POWELL and JUSTICE STEVENS join, dissenting.

In *Complete Auto Transit, Inc.* v. *Brady,* 430 U. S. 274 (1977), a unanimous Court observed: "A tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect upon interstate commerce." *Id.*, at 288-289, n. 15. In this case, appellants have alleged that Montana's severance tax on coal is tailored to single out interstate commerce, and that it produces a forbidden effect on that commerce because the tax bears no "relationship to the services provided by the State." *Ibid.* The Court today concludes that appellants are not entitled to a *trial* on this claim. Because I believe that the "careful scrutiny" due a tailored tax makes a trial here necessary, I respectfully dissent.

I

The State of Montana has approximately 25% of all known United States coal reserves, and more than 50% of the Nation's low-sulfur coal reserves.[1] Department of Energy, Demonstrated Reserve Base of Coal in the United States on January 1, 1979, p. 8 (1981); National Coal Assn., Coal Data 1978, p. I-6. Approximately 70-75% of Montana's coal lies under land owned by the Federal Government in the State. See Hearings on H. R. 6625, H. R. 6654, and H. R. 7163 before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce, 96th Cong., 2d Sess., 22 (1980) (Hearings) (statement of Rep. Vento). The great bulk of the coal mined in Montana—indeed, allegedly as much as 90%, see *ante*, at 6—is exported to other States pursuant to long-term purchase contracts with out-of-state utilities. See H. R. Rep. No. 96–1527, pt. 1, pp. 3–4 (1980). Those contracts typically provide that the costs of state taxation shall be passed on to the utilities; in turn, fuel adjustment clauses allow the utilities to pass the cost of taxation along to their consumers. *Ibid.* Because federal environmental legislation has increased the demand for low-sulfur coal, *id.*, at 3, and because the Montana coal fields occupy a "pivotal" geographic position in the midwestern and northwestern energy markets, see J. Krutilla & A. Fisher with R. Rice, Economic and Fiscal Impacts of Coal Development: Northern Great Plains xvi (1978) (Krutilla), Montana has supplied an increasing percentage of the Nation's coal.[2]

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[1] Montana and Wyoming together contain 40% of all United States coal reserves and 68% of all reserves of low-sulfur coal. H. R. Rep. No. 96-1527, pt. 1, p. 3 (1980).

In 1975, following the Arab oil embargo and the first federal coal conversion legislation, the Montana Legislature, by 1975 Mont. Laws, ch. 525, increased the State's severance tax on coal from a flat rate of approximately 34 cents per ton to a maximum rate of 30% of the "contract sales price." Mont. Code Ann. § 15–35–103 (1979).[3] See H. R. Rep. No. 96–1527, pt. 1, p. 3. The legislative history of this tax is illuminating. The Joint Conference Committees of the Montana Legislature that recommended this amendment acknowledged: "It is true that this is a higher rate of taxation than that levied by any other American state on the coal industry."[4] Statement to Accompany the Report of the Free Joint Conference Committees on Coal Taxation, p. 1. The Committees pointed out, however, that the Province of Alberta, Canada, recently had raised sharply its royalty on natural gas, thereby forcing consumers of Alberta gas in Montana and elsewhere to finance involuntarily Alberta's "universities, hospitals, reduction of other taxes, etc." *Ibid.* Stating that "we should . . . look north to Alberta," the Conference Committees observed: "While coal is not as scarce as natural gas, most of the Montana coal now produced is committed for sale under long-term contracts and will be purchased with this tax added to its price." *Ibid.* The Committees noted that although some new coal contracts might shift to Wyoming to take advantage of that State's lower severance tax, Montana's severance tax was comparable to that recently enacted by North Dakota.[5] Thus, the Com-

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[2] Together with Wyoming, Montana supplied 10% of the United States' demand for coal in 1977; it is estimated that Montana and Wyoming will supply 33% of the Nation's coal by 1990. Hearings 22 (statement of Rep. Vento).

[3] The pre-1975 rate was 12, 22, 34 or 40 cents per ton depending on the Btu content of the coal mined. Krutilla, at 50. Appellants state that coal taxed at 34 cents per ton prior to the 1975 amendment is now typically taxed at the effective rate of $2.08 per ton. Brief for Appellants 7–8.

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[4] In fact, the study of coal production taxes commissioned by the Montana Legislature in 1974, see *ante,* at 1, found that while other States may have imposed a higher overall tax burden on coal, "no coal state had, through 1973, higher severance and property taxes than Montana." Subcommittee on Fossil Fuel Taxation, Interim Study on Fossil Fuel Taxation 14 (1974). Thus, even prior to the 1975 amendment, "Montana and its local governments tax[ed] the *production* of fossil fuels at a higher rate than any competitive state . . . ." (Emphasis in original.) *Ibid.*

[5] North Dakota taxes lignite at a flat rate that is estimated to equal about 20% of value. See H. R. Rep. No. 96-1527, pt. 1, p. 3 (1980). Apparently inspired by these examples, Wyoming increased its state severance and local ad valorem taxes to a combined total of approximately 17½% of value. Wyo. Stat. §§ 39-2-202, 39-2-402, 39-6-302 (a)-(f), and 39-6-303 (a) (1977 and Supp. 1980). See H. R. Rep. No. 96-1527, pt. 1, p. 3. With the possible exception of North Dakota's tax on lignite, the severance taxes imposed by Montana and Wyoming are higher than the taxes imposed on energy reserves by any other State. *Ibid.*

Significantly, however, other western States have considered or are conmittees had no doubt that the coal industry would grow even with this tax, since "the combined coal reserves of Montana and North Dakota are simply too great a part of the nation's fossil fuel resources to be ignored because of taxes at these levels." [6] *Ibid.*

As the Montana Legislature foresaw, the imposition of this severance tax has generated enormous revenues for the State. Montana collected $33.6 million in severance taxes in fiscal year 1978. H R. Rep. No. 96–1527, pt. 1, p. 3, and appellants alleged that it would collect not less than $40 million in fiscal year 1979. App. to Juris. Statement 55a. It has been suggested that by the year 2010, Montana will have

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sidering raising their taxes on coal production. *Ibid.* One study concluded that "'[t]ax leadership' in the western states appears to be an emerging reality," and that informal cartel arrangements may arise among these States. Church, Conflicting Federal, State and Local Interest Trends in State and Local Energy Taxation: Coal and Copper—A Case in Point, 31 Nat. Tax J. 269, 278 (1978). Indeed, the 1974 Montana Subcommittee on Fossil Fuel Taxation, see n. 4, *supra*, was directed by the Montana Legislature "to investigate the feasibility and value of multistate taxation of coal with the Dakotas and Wyoming, and to contract and cooperate joining with these other states to achieve that end . . . ." House Resolution No. 45, 1974 Mont. Laws, p. 1620. The Subcommittee recommended that the Executive pursue this goal. Subcommittee on Fossil Fuel Taxation, *supra*, at 2.

[6] One of the principal sponsors of the severance tax bill explained to the Montana Legislature:

"Most of Montana's coal is shipped out of state to power plants and utility companies in the Midwest. In reviewing the [long-term] contracts between the coal companies and the utility companies who purchase the coal, all of the contracts that were shown to our Legislative Committee contain an escalation clause for taxes. In other words, the local companies simply add the additional taxes to their bill, and the entire cost is passed on to the purchasers in the Midwest or elsewhere. Because most of the purchasers are regulated utility companies, it is reasonable to assume these companies will, in turn, pass on their extra costs to their customers." Towe, Explanation of Reasons for Montana's Coal Tax 4, cited in Brief for Appellants 34.

collected more than $20 billion through the implementation of this tax. Hearings 22 (statement of Rep. Vento).

No less remarkable is the increasing percentage of total revenue represented by the severance tax. In 1972, the then current flat rate severance tax on coal provided only 0.4% of Montana's total tax revenue; in contrast, in the year following the 1975 amendment, the coal severance tax supplied 11.4% of the State's total tax revenue. See Griffin & Shelton, Coal Severance Tax Policies in the Rocky Mountain States, 7 Pol. Studies J. 29, 33 (1978). Appellants assert that the tax now supplies almost 20% of the State's total revenue. Tr. of Oral Arg. 31. Indeed, the funds generated by the tax have been so large that, beginning in 1980, at least 50% of the severance tax is to be transferred and dedicated to a permanent trust fund, the principal of which must "forever remain inviolate" unless appropriated by a vote of three-fourths of the members of each house of the legislature. Mont. Const., Art. IX, § 5. Moreover, in 1979, Montana passed legislation providing property and income tax relief for state residents. 1979 Mont. Laws, ch. 698.

Appellants' complaint alleged that Montana's severance tax is ultimately borne by out-of-state consumers, and for the purposes of this appeal that allegation is to be treated as true.[7] Appellants further alleged that the tax bears no reasonable relationship to the services or protection provided by the State. The issue here, of course, is whether they are entitled to a trial on that claim, not whether they will succeed on the merits. It should be noted, however, that Montana imposes numerous other taxes upon coal mining.[8] In addition, because 70% to 75% of the coal-bearing land in Montana is owned by the Federal Government, Montana derives a large amount of coal mining revenue from the United States as well.[9] In light of these circumstances, the Interstate and Foreign Commerce Committee of the United States House of Representatives concluded that Montana's coal severance tax results in revenues "far in excess of the direct and indirect impact costs attributable to the coal production." H. R. Rep. No. 96-1527, pt. 1, p. 2. Several commentators have agreed that Montana and other similarly situated western States have pursued a policy of "OPEC-like revenue maximization," and that the Montana tax accordingly bears no reasonable relationship to the services and protection afforded by the State. R. Nehring & B. Zycher with J. Wharton, Coal Development and Government Regulation in the Northern Great Plains: A Preliminary Report 148 (1976); Church, at 272. See Krutilla, at 185. These findings, of course, are not dispositive of the issue whether the Montana severance tax is "fairly related" to the services

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[7] The Montana Supreme Court observed that under Montana law, facts well pleaded in the complaint must be accepted as true on review of a judgment of dismissal; it therefore necessarily held that appellants could not prevail "under any view of the alleged facts." — Mont. —, 615 P. 2d 847, 849 (1980). See also Tr. of Oral Arg. 17–18.

[8] In addition to the severance tax on coal, Montana imposes a gross proceeds tax, Mont. Code Ann. § 15-6-132 (1979), a resource indemnity

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trust tax, § 15-38-104, a property tax on mining equipment, § 15-6-138 (b), and a corporation license tax, § 15-31-101. See Krutilla, at 50-54. Furthermore, all costs of reclamation must be borne by the coal companies under both federal and state law, and Montana requires each company to purchase a reclamation bond prior to the commencement of mining operations. § 82-4-338.

[9] By federal statute, 50% of the "sales, bonuses, royalties, and rentals" of federal public lands are payable to the State within which the leased land lies "to be used by such State and its subdivisions, as the legislature of the State may direct giving priority to those subdivisions of the State socially or economically impacted by development of minerals leased under this chapter, for (i) planning, (ii) construction and maintenance of public facilities and (iii) provision of public service . . . ." Mineral Lands Leasing Act of 1920, § 35, 41 Stat. 450, as amended, 30 U. S. C. § 191. An additional 40% of this federal revenue from mineral leases is indirectly returned to the States through a reclamation fund. *Ibid.* Moreover, § 601 of the Powerplant and Industrial Fuel Use Act of 1978, Pub. L. 95-650, 92 Stat. 3323, 42 U. S. C. § 8401 (1976 ed., Supp. III), authorizes federal grants to areas affected by increased coal production.

provided by the State within the meaning of our prior cases. They do suggest, however, that appellants' claim is a substantial one. The failure of the Court to acknowledge this stems, it seems to me, from a misreading of our prior cases. It is to those cases that I now turn.

II

This Court's Commerce Clause cases have been marked by tension between two competing concepts: the view that interstate commerce should enjoy a "free trade" immunity from state taxation, see, *e. g., Freeman* v. *Hewit,* 329 U. S. 249, 252 (1946), and the view that interstate commerce may be required to "'pay its way,'" see, *e. g., Western Live Stock* v. *Bureau of Revenue,* 303 U. S. 250, 254 (1938). See generally *Complete Auto Transit, Inc.* v. *Brady,* 430 U. S., at 278–281, 288–289, n. 15; Simet & Lynn, Interstate Commerce Must Pay Its Way: The Demise of Spector, 31 Nat. Tax J. 53 (1978); Hellerstein, Foreword, State Taxation Under the Commerce Clause: An Historical Perspective, 29 Vand. L. Rev. 335, 335–339 (1976). In *Complete Auto Transit,* the Court resolved that tension by unanimously reaffirming that interstate commerce is not immune from state taxation. 430 U. S., at 288. But at the same time the Court made clear that not all state taxation of interstate commerce is valid; a state tax will be sustained against Commerce Clause challenge *only* if "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.,* at 279. See *Maryland* v. *Louisiana,* — U. S. —, — (1981) (slip op. 27).

The Court today acknowledges and, indeed, holds that a Commerce Clause challenge to a state severance tax must be evaluated under *Complete Auto Transit's* four-part test. *Ante,* at 6. I fully agree. I cannot agree, however, with the

Court's application of that test to the facts of the present case. Appellants concede, and the Court properly concludes, that the first two prongs of the test—substantial nexus and fair apportionment—are satisfied here. The Court also correctly observes that Montana's severance tax is facially neutral. It does not automatically follow, however, that the Montana severance tax does not unduly burden or interfere with interstate commerce. The gravamen of appellants' complaint is that the severance tax does not satisfy the fourth prong of the *Complete Auto Transit* test because it is tailored to, and does, force interstate commerce to pay *more* than its way. Under our established precedents, appellants are entitled to a trial on this claim.

The Court's conclusion to the contrary rests on the premise that the relevant inquiry under the fourth prong of the *Complete Auto Transit* test is simply whether the *measure* of the tax is fixed as a percentage of the value of the coal taken. *Ante,* at 15. This interpretation emasculates the fourth prong. No trial will ever be necessary on the issue of fair relationship so long as a State is careful to impose a proportional rather than a flat tax rate; thus, the Court's rule is no less "mechanical" than the approach entertained in *Heisler* v. *Thomas Colliery Co.*, 260 U. S. 245 (1922), disapproved today, *ante,* at 5.[10] Under the Court's reasoning, any ad valorem tax will satisfy the fourth prong; indeed, the Court implicitly ratifies Montana's contention that it is free to tax this coal at 100% or even 1000% of value, should it choose to do so. Tr. of Oral Arg. 21. Likewise, the Court's analysis indicates that Montana's severance tax would not run afoul of the Commerce Clause even if it raised sufficient revenue to allow Montana to eliminate all other taxes upon its citizens.[11]

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[10] This is a marked departure from the Court's prior cases. Rather than suggesting such a mechanical test, those cases imply that a tax will be struck down under the fourth prong of the *Complete Auto Transit* test if the plaintiff establishes a factual record that the tax is not fairly related to the services and protection provided by the State. See, *e. g*, *Washington Rev. Dept.* v. *Stevedoring Assn.*, 435 U. S. 734, 750–751 (1978); *id.*, at 764 (POWELL, J., concurring in part and concurring in the result). See *Merrion* v. *Jicarilla Apache Tribe*, 617 F. 2d 537, 545, n. 4 (CA10 1980) (en banc), cert. pending, Nos. 80-11 and 80-15. Even the trial court in the present case recognized that if it reached this question it "would necessarily have to deny the motion to dismiss and proceed to a factual determination." App. 37a.

The Court's prior cases neither require nor support such a startling result.[12] The Court often has noted that "'[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their *just share* of state tax burden even though it increases the cost of doing the business.'" *Complete Auto Transit*, 430 U. S., at 279 (emphasis added), quoting *Western Live Stock*, 303 U. S., at 254. See *Maryland* v. *Louisiana*, — U. S., at — (slip op. 27). Accordingly, interstate commerce cannot claim any exemption from a state tax that "is fairly related to the services provided by the State." *Complete Auto Transit*, 430 U. S., at 279. We have not interpreted this requirement of "fair relation" in a narrow sense; interstate commerce may be required to share equally with intrastate commerce the cost of providing "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.'" *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U. S. 207, 228 (1980), quoting *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434, 445 (1979). See, *e. g.*, *Nippert* v. *Richmond*, 327 U. S. 416, 433 (1946). Moreover, interstate commerce can be required to "pay its own way" in a narrower sense as well: the State may tax interstate commerce for the purpose of recovering those costs attributable to the activity itself. See, *e. g.*, *Postal Telegraph-Cable Co.* v. *Richmond*, 249 U. S. 252 (1919).[13]

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[11] As the example of Alaska illustrates, this prospect is not a fanciful one. Ninety percent of Alaska's revenue derives from petroleum taxes and royalties; because of the massive sums that have been so raised, that State's income tax has been eliminated. See N. Y. Times, June 5, 1981, section 1, p. A10, col. 1. As noted above, Montana's severance tax already allegedly accounts for 20% of its total tax revenue, and the State has enacted property and income tax relief.

[12] The Court apparently derives its interpretation of the fourth prong of the *Complete Auto Transit* test primarily from *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435 (1940), and *General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964). *Ante*, at 13–15. In neither of those cases, however, did the Court consider the question presented here. *J. C. Penney* involved a *Fourteenth Amendment* challenge brought by a foreign corporation to a Wisconsin tax imposed on domestic and foreign corporations "for the privilege of declaring . . . dividends" out of income from property located and business transacted in Wisconsin. The corporation argued that because the income from the Wisconsin transactions had been transferred to New York, Wisconsin had "no jurisdiction to tax" those amounts. 311 U. S., at 436. The Court rejected that argument, holding that "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and the transactions within a state for which the tax is an exaction." *Id.*, at 445. In *General Motors*, the question before the Court was the validity of an unapportioned tax on the gross receipts of a corporation in interstate commerce. The Court concluded that there was a sufficient nexus to uphold the tax. 377 U. S., at 448. See *id.*, at 449–450 (BRENNAN, J., dissenting).

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[13] In *Postal Telegraph-Cable Co.*, a telegraph company engaged in interstate commerce challenged both an annual license tax and an annual tax of $2 for each telegraph pole that the company maintained in the city of Richmond, Va. The Court sustained the validity of the license tax on the ground that it was simply a nondiscriminatory "exercise of the police power . . . for revenue purposes." 249 U. S., at 257. In contrast, the pole tax was subjected to stricter scrutiny; the Court stated that while interstate commerce must pay its way, the authority remains in the courts,

> "on proper application, to determine whether, under the conditions prevailing in a given case, the charge made is reasonably proportionate to the service to be rendered and the liabilities involved, or whether it is a disguised attempt to impose a burden on interstate commerce." *Id.*, at 260.

The Court has continued to scrutinize carefully taxes on interstate commerce that are designed to reimburse the State for the particular costs imposed by that commerce. See, *e. g.*, *Evansville-Vanderburgh Airport Authority* v. *Delta Airlines, Inc.*, 405 U. S. 707 (1972); *Clark* v. *Paul*

The Court has never suggested, however, that interstate commerce may be required to pay *more* than its own way. The Court today fails to recognize that the Commerce Clause does impose limits upon the State's power to impose even facially neutral and properly apportioned taxes. See *ante*, at 11–12. In *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U. S. 157, 163 (1954), Texas argued that no inquiry into the constitutionality of a facially neutral tax on the "taking" of gas was necessary because the State "has afforded great benefits and protection to pipeline companies." The *Calvert* Court rejected this argument, holding that "these benefits are relevant here only to show that the essential requirements of due process have been met sufficient to justify the imposition of *any* tax on the interstate activity." *Id.*, at 163–164. The Court held, *id.*, at 164, that when a tax is challenged on Com-

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Gray, Inc., 306 U. S. 583 (1939); *Ingels* v. *Morf*, 300 U. S. 290 (1937). In analyzing such taxes, it has required that there be factual evidence in the record that "the fees charged do not appear to be manifestly disproportionate to the services rendered." *Clark*, 306 U. S., at 599. The Court concludes that this test has no bearing here because the Montana Supreme Court held that the coal severance tax was "imposed for the general support of the government." *Ante*, at 10. In fact, however, the matter is not nearly so clear as the Court suggests. The Montana court also implied that the tax was designed at least in part to compensate the State for the special costs attributable to coal mining, — Mont., at —, —, 615 P. 2d, at 850, 855, as have appellees here. Brief for Appellees 1–3, 26–27.

Indeed, the stated objectives of the 1975 amendment were to: "(a) preserve or modestly increase revenues going to the general fund, (b) to respond to current social impacts attributable to coal development, and (c) to invest in the future, when new energy technologies reduce our dependence on coal and mining activity may decline." Statement to Accompany the Report of the Free Joint Conference Committees on Coal Taxation, p. 1. Since the tax was designed only to "preserve or modestly increase" general revenues, it is appropriate for a court to inquire here whether the "surplus" revenue Montana has received from this severance tax is "manifestly disproportionate" to the present or future costs attributable to coal development.

merce Clause grounds its validity " 'depends on other considerations of constitutional policy having reference to the substantial effects, actual or potential, of the particular tax in suppressing or burdening unduly the commerce.' " quoting *Nippert* v. *Richmond*, 327 U. S., at 424. Accordingly, while the Commerce Clause does not require that interstate commerce be placed in a privileged position, it does require that it not be unduly burdened. In framing its taxing measures to reach interstate commerce, the State must be "at pains to do so in a manner which avoids the evils forbidden by the commerce clause and puts that commerce *actually* on a plane of equality with local trade in local taxation." *Nippert*, 327 U. S., at 434 (emphasis added).

Thus, the Court has been particularly vigilant to review taxes that "single out interstate business," since "[a]ny tailored tax of this sort creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." *Complete Auto Transit*, 430 U. S., at 288–289, n. 15.[14] Moreover, the Court's vigilance has not been limited to taxes that discriminate upon their face: "Not the tax in a vacuum of words, but its practical consequences for the doing of interstate commerce in applications to concrete facts are our concern." *Nippert*, 327 U. S., at 431. See *Maryland* v. *Louisiana*, — U. S., at — (slip op. 29). This is particularly true when the challenged tax, while facially neutral, falls so heavily upon interstate commerce that its burden "is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state." *McGoldrick* v. *Berwind-White Co.*, 309 U. S. 33, 46, n. 2 (1940). Cf. *Raymond Motor Transportation, Inc.* v. *Rice*, 434 U. S. 429, 446–447 (1978). In sum, then, when a tax has been "tailored" to reach interstate commerce, the Court's cases suggest that we require a closer "fit" under the fourth prong of the *Complete Auto Transit* test than when interstate commerce has not been singled out by the challenged tax.

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[14] *Complete Auto Transit* gave several examples of "tailored" taxes: property taxes designed to differentiate between property used in transportation and other types of property; an income tax using different rates for different types of business; and a tax on the "privilege of doing business in corporate form" that changed with the nature of the corporate activity involved. 430 U. S., at 288, n. 15. A severance tax using different rates for different minerals is, of course, directly analogous to these examples.

As a number of commentators have noted, state severance taxes upon minerals are particularly susceptible to "tailoring." "Like a tollgate lying athwart a trade route, a severance or processing tax conditions access to natural resources." Developments in the Law, Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev. 953, 970 (1962) (Harvard Developments). Thus, to the extent that the taxing jurisdiction approaches a monopoly position in the mineral, and consumption is largely outside the State, such taxes are "[e]conomically and politically analogous to transportation taxes exploiting geographical position." Brown, The Open Economy: Justice Frankfurter and the Position of the Judiciary, 67 Yale L. J. 219, 232 (1957). See also Hellerstein, Constitutional Constraints on State and Local Taxation of Energy Resources, 31 Nat. Tax J. 245, 249–250 (1978); R. Posner, Economic Analysis of Law 510–514 (2d ed. 1977). But just as a port State may require that imports pay their own way even though the tax levied increases the cost of goods purchased by inland customers, see *Michelin Tire Corp.* v. *Wages*, 423 U. S. 276, 288 (1976),[15] so also may a mineral-rich State require that those who consume its resources pay a fair share of the general costs of government, as well as the specific costs attributable to the commerce itself. Thus, the mere fact that the burden of a severance tax is largely shifted forward to out-of-state consumers does not, standing alone, make out a Commerce Clause violation. See Hellerstein, *supra,* at 249. But the Clause *is* violated when, as appellants allege is the case here, the State effectively selects "a class of out-of-state taxpayers to shoulder a tax burden grossly in excess of any costs imposed directly or indirectly by such taxpayers on the State." *Ibid.*

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[15] See also *Washington Rev. Dept.* v. *Stevedoring Assn.*, 435 U. S. 734, 754–755 (1978); *id.*, at 764 (POWELL, J., concurring in part and concurring in the result).

III

It is true that a trial in this case would require "complex factual inquiries" into whether economic conditions are such that Montana is in fact able to export the burden of its severance tax, *ante,* at 8, n. 8.[16] I do not believe, however, that this threshold inquiry is beyond judicial competence.[17] If the trial court were to determine that the tax is exported, it would then have to determine whether the tax is "fairly related," within the meaning of *Complete Auto Transit.* The

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[16] The degree to which a tax may be "exported" turns on such factors as the taxing jurisdiction's relative dominance of the market, the elasticity of demand for the product, and the availability of adequate substitutes. See, *e. g.,* McLure, Economic Constraints on State and Local Taxation of Energy Resources, 31 Nat. Tax J. 257, 257–259 (1978); Posner, at 510–512. Commentators are in disagreement over the likelihood that coal severance taxes are in fact exported. Compare, *e. g.,* McLure, at 259, and Gillis & Peprah, Severance Taxes on Coal and Uranium in the Sunbelt, Tex. Bus. Rev. 302, 308 (1980), with Church, at 277, and Griffin, at 33. It is clear, however, that that likelihood increases to the extent that the taxing States form a cartel arrangement. Gillis, at 308. See n. 5, *supra.* Whether the tax is in fact exported here is, of course, an issue for trial.

[17] There is no basis for the conclusion that the issues presented would be more difficult than those routinely dealt with in complex civil litigation. See, *e. g., Milwaukee* v. *Illinois,* — U. S., —, — (1981) (slip op. 17) (dissenting opinion). "The complexity of a properly presented federal question is hardly a suitable basis for denying federal courts the power to adjudicate." *Id.,* at —, n. 25.

Court to the contrary, this would not require the trial court "to second-guess legislative decisions about the amount or disposition of tax revenues." *Ante*, at 16, n. 16. If the tax is in fact a legitimate general revenue measure identical or roughly comparable to taxes imposed upon similar industries, a court's inquiry is at an end; on the other hand, if the tax singles out this particular interstate activity and charges it with a grossly disproportionate share of the general costs of government,[18] the court must determine whether there is some reasonable basis for the legislative judgment that the tax is necessary to compensate the State for the particular costs imposed by the activity.

To be sure, the task is likely to prove to be a formidable one; but its difficulty does not excuse our failure to undertake it. This case poses extremely grave issues that threaten both to "polarize the Nation," see H. R. Rep. No. 96-1527, pt. 1, p. 2 (1980), and to reawaken "the tendencies toward economic Balkanization" that the Commerce Clause was designed to remedy. See *Hughes* v. *Oklahoma*, 441 U. S. 322, 325-326 (1979). It is no answer to say that the matter is better left to Congress:[19]

"While the Constitution vests in Congress the power to

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[18] See n. 13, *supra*. Cf. *Maryland* v. *Louisiana*, — U. S. —, —, n. 27 (slip op. 28, n. 27) (reciting argument of United States that use of 75% of proceeds of Louisiana's "First-Use Tax" to service general debt, and only 25% to alleviate alleged environmental damage from pipeline activities, suggests that tax was not fairly apportioned to value of activities occurring within the State.)

[19] As the Court notes, the issue has not escaped congressional attention. *Ante*, at 17. No bill, however, has yet been passed, and this Court is not disabled to act in the interim; to the contrary, strong policy and institutional considerations suggest that it is appropriate that the Court consider this issue. See Brown, at 222. Indeed, whereas Montana argues that the question presented here is one better left to Congress, in 1980 hearings before the Senate Committee on Energy and Natural Resources, the then Governor of Montana took the position that the reasonableness of this tax was "a question most properly left to [the] court," not a congressional

> regulate commerce among the states, it does not say what the states may or may not do in the absence of congressional action . . . . Perhaps even more than by its interpretation of the written word, this Court has advanced the solidarity and prosperity of this Nation by the meaning it has given to these great silences of the Constitution." *H. P. Hood & Sons, Inc.* v. *Du Mond*, 336 U. S. 525, 534–535 (1949).

I would not lightly abandon that role.[20] Because I believe that appellants are entitled to an opportunity to prove that, in Holmes' words, Montana's severance tax "embodies what the Commerce Clause was meant to end," I dissent.[21]

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committee. See Hearing on S. 2695 before the Senate Committee on Energy and Natural Resources, 96th Cong., 2d Sess., 237 (1980).

[20] Justice Holmes' words are relevant:

"I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what the Commerce Clause was meant to end." O. Holmes, Law and the Court, in Collected Legal Papers 291, 295–296 (reprint, 1952).

[21] I agree with the Court that appellants' Supremacy Clause claims are without merit.